SPS COMMERCE INC
Form 10-K
February 22, 2019
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Fiscal Year Ended: December 31, 2018

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Transition Period from to

Commission file number 001-34702

SPS COMMERCE, INC.

(Exact Name of Registrant as Specified in its Charter)

Delaware	41-2015127
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

333 South Seventh Street, Suite 1000, Minneapolis, MN 55402

(Address of Principal Executive Offices, Including Zip Code)

(612) 435-9400

(Registrant’s Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(b) of the Act:

Common stock, par value $0.001 per share	The Nasdaq Stock Market LLC (Nasdaq Global Market)
(Title of each class)	(Name of each exchange on which registered)

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer	Accelerated Filer
Non-Accelerated Filer	Smaller Reporting Company
	Emerging Growth Company

Indicate by check mark whether the registrant is an emerging growth company as defined in Rule 405 of the Securities Act of 1933 (§230.405 of this chapter) or Rule 12b-2 of the Securities Exchange Act of 1934 (§240.12b-2 of this chapter). Emerging growth company.

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of June 29, 2018, the last business day of the registrant's most recently completed second fiscal quarter, the aggregate market value of shares of the registrant's common stock held by non-affiliates of the registrant (based upon the closing sale price of $73.48 per share on the Nasdaq Global Market on such date) was approximately $1.3 billion.

The number of shares of the registrant's common stock, par value $0.001 per share, outstanding as of February 8, 2019 was 17,760,003 shares.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company's definitive Proxy Statement for the Annual Meeting of Stockholders to be held on May 14, 2019 (the "2019 Proxy Statement"), which is expected to be filed within 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K, are incorporated by reference in Part III of this Annual Report on Form 10-K.

SPS COMMERCE, INC.

ANNUAL REPORT ON FORM 10-K

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Unless the context otherwise requires, for purposes of the Annual Report on Form 10-K, the words "we," "us," "our," the "Company," and "SPS" refer to SPS Commerce, Inc.

SPECIAL NOTE REGARDING FORWARD-LOOKING INFORMATION

This Annual Report on Form 10-K contains forward-looking statements within the meaning of the U.S. Private Securities Litigation Reform Act of 1995. Forward looking statements regarding us, our business prospects and our results of operations are subject to certain risks and uncertainties posed by many factors and events that could cause our actual business, prospects and results of operations to differ materially from those that may be anticipated by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those described under the heading “Risk Factors” included in this Annual Report on Form 10-K. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this report. In some cases, you can identify forward-looking statements by the following words: “anticipate,” “assumes,” “believe,” “continue,” “could,” “estimate,” “expect,” “intend,” “may,” “ongoing,” “plan,” “potential,” “predict,” “project,” “sh or the negative of these terms or other comparable terminology, although not all forward-looking statements contain these words. We expressly disclaim any intent or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Readers are urged to carefully review and consider the various disclosures made by us in this report and in our other reports filed with the Securities and Exchange Commission (“SEC”) that advise interested parties of the risks and factors that may affect our business.

PART I

Item 1. Business
Overview

SPS Commerce is a leading provider of cloud-based supply chain management services that make it easier for retailers, suppliers, grocers, distributors and logistics firms to orchestrate the management of item data, order fulfillment, inventory control and sales analytics across all channels. Implementing and maintaining a suite of supply chain management capabilities is resource intensive and is not a core competency for most businesses. The services offered by SPS Commerce eliminate the need for on-premise software and support staff by taking on that capability on the customer's behalf. The services SPS Commerce provides allow our customers to increase their supply cycle agility, optimize their inventory levels and sell-through, reduce operational costs and gain increased visibility into customer orders, ensuring that suppliers, grocers, distributors, and logistics firms can satisfy exacting retailer requirements.

As of December 31, 2018, we had approximately 29,000 customers with contracts to pay us monthly fees, which we refer to as recurring revenue customers. We have also generated revenues by providing our cloud-based supply chain management services to an additional 51,000 organizations that, together with our recurring revenue customers, we refer to as our customers. Once connected to the SPS Commerce Platform, our customers often require integrations to new organizations that represent an expansion of our Platform and new sources of revenues for us.

For the years ended December 31, 2018, 2017 and 2016, we generated revenues of $248.2 million, $220.1 million and $193.2 million, respectively. Our fiscal quarter ended December 31, 2018 represented our 72nd consecutive quarter of increased revenues. Recurring revenues from recurring revenue customers accounted for 93%, 93% and 92% of our total revenues for the years ended December 31, 2018, 2017 and 2016, respectively. Our revenues are not concentrated with any customer, as our largest customer represented less than 1% of total revenues for the years ended December 31, 2018, and 2017 and less than 2% of total revenues for the year ended December 31, 2016.

Our Solutions

SPS Commerce operates one of the largest retail trading partner networks through cloud-based services that improve the way retailers, suppliers, grocers, distributors and logistics firms manage and fulfill orders, administer sell-through performance and source new items. Today, approximately 80,000 customers across more than 60 countries are using SPS Commerce solutions to expand and optimize the performance of their trading relationships.

The SPS Commerce business model fundamentally changes how organizations use electronic communication to manage their omnichannel, supply chain, and other business requirements by replacing the collection of traditional, custom-built, point-to-point integrations with a model that facilitates a single automated connection to the entire SPS Commerce network of trading partners.

From that single connection, a member of our network can make use of the full suite of our services, from fulfillment automation, to the analysis and optimization of item sell-through performance, to sourcing new items, retailing relationships, logistics providers, or other services. These cloud services deliver value as stand-alone offerings but can also provide greater value when used collectively. This represents a fundamental change to fulfillment automation and enables inherent adaptability and flexibility not possible with traditional supply chain management system architectures.

Our fulfillment service allows customers to comply with numerous rulebooks for retailers, grocers and distributors. Maintaining current connections with retailers, grocers, and distributors removes the need for their trading partners to continually stay up-to-date with their required rulebook change. The utilization of a cloud services model eliminates or greatly reduces the burden on trading partners to support and maintain an on-premise software application, thereby reducing ongoing operating costs. As the transaction hub for trading partners, we can provide increased performance visibility and data analytics capabilities across their supply chains, each of which is difficult to gain from traditional, point-to-point integration solutions.

The following services are enabled through the SPS Commerce cloud services Platform:

- Trading Partner Community. The Community solution empowers retailers, grocers, and distributors to introduce changes to their supply chain requirements to their trading partner community, and onboard new vendors quickly to receive their first orders.
- Trading Partner Fulfillment. The Fulfillment solution provides fulfillment automation and replaces or augments an organization's existing staff and trading partner electronic communication infrastructure by enabling easy compliance with retailers' rulebooks, electronic exchange of information among numerous trading partners through various protocols, and greater visibility into the journey of an order.
- Trading Partner Assortment. Today's retail marketplace requires the management of tens and even hundreds of individual attributes associated with each item a retailer or supplier sells. This information can include supply chain descriptions and measurements, store and shelf dimensions, warehouse dimensions, digital images/video, customer facing descriptions and measurements, and warehouse information. The Assortment solution provides robust, extensible, management of this information, enabling accurate orders and rapid fulfillment.
- Trading Partner Analytics. The Analytics solution consists of data analytics applications that allow our customers to improve their visibility across, and analysis of, their supply chains. When focused on point-of-sale data, for example, retailers and suppliers can ensure inventory is located where demand is highest. Additionally, retailers improve their visibility into supplier performance and their understanding of product sell-through.
- Trading Partner Sourcing. Through the Sourcing Solution, retailers can leverage our social network for the retail industry, and source providers of new items, suppliers can connect with new retailers, and the broader retailing community can make connections to expand their business networks and grow.
- Other Trading Partner Solutions. We provide a number of peripheral solutions such as barcode labeling, planogram services and our scan and pack application, which helps trading partners process information to streamline the picking and packaging process.

Our Customer and Sales Sources

As one of the largest providers of cloud services for retail supply chain management, the trading partner relationships that we enable among our retailer, supplier, grocer, distributor, and logistics customers naturally lead to new customer acquisition opportunities.

"Network Effect"

Once connected to our network, trading partners can exchange electronic supply chain information with each other. The value of our network increases with the number of trading partners connected to it. The addition of each new customer enables that new customer to communicate with our existing customers and permits our existing customers to do business with the new customer. Additionally, through our Sourcing service, our community now has a social network focused on facilitating connections and business interactions among retailers and suppliers. This "network effect" of adding additional customers to our solutions infrastructure creates a significant opportunity for existing customers to realize incremental sales by working with our new trading partners and vice versa. As a result of this increased volume of activity among our network participants, we earn additional revenues from these participants.

Customer Acquisition Sources

Community. As retailers and suppliers reshape how they do business in an omnichannel landscape, they need to bring new capabilities and services to their trading partner networks. For instance, a supplier may wish to collaborate with their retailers around point-of-sale analytics data, or a retailer may decide to change the workflow or protocol by which it interacts with its suppliers. In each case, the supplier and retailer may engage us to work with its trading partner base to enable the new capability. Performing these programs on behalf of retailers and suppliers often generates supplier sales leads for us.

Referrals from Our Customers. We also receive sales leads from our customers seeking to communicate electronically with their trading partners. For example, a supplier may refer to us its third-party logistics provider or manufacturer which is not in our network.

Channel Partners. In addition to the customer acquisition sources identified above, we market and sell our solutions through a variety of channel partners including software providers, resellers, system integrators and logistics partners. For example, software partners such as Microsoft, NetSuite, Oracle, SAP, Sage and their business partner communities generate sales for us as part of broader enterprise resource planning, warehouse management system and/or transportation management system sales efforts. Our logistics partners also drive new sales both by providing leads and by embedding our solutions as part of their service offerings.

Our Sales Force

We also sell our solutions through a global sales force which is organized as follows:

- Retailer Sales. We employ a team of sales representatives who focus on selling our cloud services suite to retailers and distributors.
- Supplier Sales. We employ a team of supplier sales representatives focused on selling our cloud services suite to suppliers.
- Logistic Sales. We employ a team of logistic sales representatives focused on selling our cloud services suite to logistic service providers.
- Business Development Efforts. Our business development organization is tasked with finding new sources of revenue and development of new business opportunities through channel partners and other areas that present an opportunity for growth.

Our Growth Strategy

Our objective is to be the leading global provider of supply chain management solutions. Key elements of our strategy include:

- Further Penetrate Our Current Market. We believe the global supply chain management market is underpenetrated and, as the retail industry continues to respond to the changing requirements of the omnichannel marketplace, and as the supply chain ecosystem becomes more complex and geographically dispersed, the demand for supply chain management solutions will increase, especially among small- and medium-sized businesses. We intend to continue leveraging our relationships with customers and their trading partners to obtain new sales leads.
- Increase Revenues from Our Customer Base. We believe our overall customer satisfaction is strong and will lead our customers to further expand their use of the solutions they have purchased, as well as purchase additional services to continue improving the performance of their trading partner relationships, generating additional revenues for us. We also expect to introduce new solutions to sell to our customers. We believe our position as the incumbent supply chain management solution provider to our customers, our integration into our recurring revenue customers’ business systems and the modular nature of our Platform are conducive to deploying additional solutions with customers.

- Expand Our Distribution Channels. We intend to grow our business by expanding our sales capacity to gain new customers. We also believe there are valuable opportunities to promote and sell our solutions through collaboration with other providers.

- Expand Our International Presence. We believe our presence in the Asia Pacific, as well as in Europe, represents a significant competitive advantage. We plan to increase our global sales efforts to obtain new customers around the world. We intend to leverage our current global presence to increase the number of integrations we have with retailers in foreign markets to make our solutions more valuable to their trading partners based overseas.
- Enhance and Expand Our Services. We intend to further improve and develop the functionality and features of our Platform, including, from time to time, developing new solutions and applications.
- Selectively Pursue Strategic Acquisitions. The fragmented nature of our market provides an opportunity for selective acquisitions. We plan to evaluate potential acquisitions based on the number of new customers, revenue, functionality, or geographic reach the acquisition would provide relative to the purchase price and our ability to integrate and operate the acquired business. In 2018, we acquired EDIAdmin, a leading provider of supply chain integration technology. Also, in 2018, we acquired CovalentWorks, a provider of cloud-based EDI solutions to small- and medium-sized businesses. These acquisitions further extended the power of our network.

Technology, Development and Operations

Technology

SPS Commerce was an early provider of cloud services to the retail supply chain management industry, launching the first version of what would become our current services in 1997. We use commercially available hardware and cloud services with a combination of proprietary and commercially available software.

Our cloud service model treats all customers as logically separate tenants within a shared virtual infrastructure. As a result, we spread the cost of delivering our solutions across our customer base. Because we do not manage thousands of distinct applications with their own business logic and database schemes, we believe that we can scale our business faster than traditional software vendors, even those that modified their products to be accessible over the Internet.

Development

Our research and development efforts focus on maintaining, improving and enhancing our existing solutions, as well as developing new solutions and applications. Our multi-tenant solutions serve all of our customers, which allows us to maintain relatively low research and development expenses and release software updates more frequently compared to traditional on-premise licensed software solutions that support multiple versions. Our development efforts take place at our U.S. locations in Minnesota and New Jersey; as well as in Melbourne, Australia; Toronto, Canada; and Kiev, Ukraine.

Operations

We operate our infrastructure in third-party data centers located in Minnesota, New Jersey, and Melbourne, Australia, as well as provisioned services in public cloud providers. In all cases, infrastructure and services are managed by us.

We have internal and third-party monitoring software that continually checks our network and key underlying components for continuous availability and performance, ensuring the network is always available and providing adequate service levels. We have a technology operations team that provides system provisioning, management, maintenance, monitoring and back-up.

We operate a service architecture using industry best practices to ensure multiple points of redundancy, high availability and scale as needed. Our databases are replicated between locations with a defined recovery point objective.

Our Customers

As of December 31, 2018, we had approximately 29,000 recurring revenue customers and approximately 80,000 total customers. Our primary source of revenue is from small- to mid-sized suppliers. We also generate revenues from other members of the supply chain ecosystem, including retailers, distributors, third-party logistics providers and other trading partners. Our revenues are not concentrated with any customer, as our largest customer represented less than 1% of total revenues for both the years ended December 31, 2018 and 2017 and less than 2% of total revenues for the year ended December 31, 2016.

Competition

Vendors in the supply chain management industry offer solutions through three delivery methods: traditional on-premise software, cloud-based managed services and cloud-based full-service solutions.

The market for cloud-based supply chain management solutions is fragmented and rapidly evolving. Cloud service vendors compete directly with each other based on the following:

- the breadth of pre-built connections to retailers, third-party logistics providers, and other trading partners;
- a history of establishing and maintaining reliable connections with trading partners;
- a reputation of the cloud service vendor in the supply chain management industry;
- price;
- specialization in a customer market segment;
- speed and quality with which the cloud service vendor can integrate its customers to their trading partners;
- functionality of the cloud service solution, such as the ability to integrate the solution with a customer's business systems;
- breadth of complementary supply chain management solutions the cloud service vendor offers; and
- training and customer support services provided during and after a customer's initial integration.

We expect to encounter new and increased competition as this market segment consolidates and matures. Consolidation among cloud service vendors could create a direct competitor that can compete with us more effectively than the numerous, smaller vendors currently offering cloud service supply chain management solutions. Increased competition from cloud service vendors could reduce our market share, revenues, and operating margins or otherwise adversely affect our business.

Cloud service vendors also compete with traditional on-premise software companies. Traditional on-premise software companies focused on supply chain integration management include IBM Sterling Commerce and OpenText-GXS. These companies offer a "do-it-yourself" approach in which customers purchase, install, and manage specialized software, hardware and value-added networks for their supply chain integration needs. This approach requires customers to invest in staff to operate and maintain the software. Traditional on-premise software companies use a single-tenant approach in which information maps to retailers are built for and used by one supplier, as compared to cloud service solutions that allow multiple customers to share information maps with a retailer.

Managed service providers focused on the supply chain management market include IBM Sterling Commerce, OpenText GXS, TrueCommerce, DiCentral, B2B Gateway and many other small providers. These companies offer a cloud-based solution in which they develop and maintain the core technology, while the customer's internal staff is responsible for the day-to-day customization, optimization, and operations of the technology.

In contrast, full-service providers, including SPS Commerce, offer cloud-based solutions and that customize, optimize and operate the technology. This approach offloads the time-intensive process of managing these solutions, which is not a core competency for most businesses.

Customers of traditional on-premise software providers must typically make significant upfront investments in the supply chain management solutions these competitors provide, which can decrease the customers' willingness to abandon their investments in favor of a cloud service solution. Cloud service vendors compete with these traditional software solutions based on total cost of ownership and flexibility.

Intellectual Property and Proprietary Content

SPS Commerce relies on a combination of copyright, trademark and trade secret laws as well as confidentiality procedures and contractual provisions to protect our proprietary technology and our brand. We enter into confidentiality and proprietary rights agreements with our employees, consultants and other third parties and control access to software, documentation and other proprietary information. We have registered trademarks and pending trademark applications in the U.S. and certain foreign countries.

Depending on the jurisdiction, trademarks are generally valid as long as they are in use or their registrations are properly maintained and they have not been found to have become generic. Registrations of trademarks can also generally be renewed indefinitely as long as the trademarks are in use. We do not have any patents, but we have pending patent applications. Our trade secrets consist primarily of the software we have developed for our SPS Commerce Network. Our software is also protected under copyright law, but we do not have any registered copyrights.

Employees

As of December 31, 2018, we had 1,231 employees. We also employ independent contractors to support our operations. We believe that our continued success will depend on our ability to continue to attract and retain skilled technical and sales personnel. We have never had a work stoppage, and none of our employees are represented by a labor union. We believe our relationship with our employees is good.

Company Information

We were originally incorporated as St. Paul Software, Inc., a Minnesota corporation, on January 28, 1987. On May 30, 2001, we reincorporated in Delaware under our current name, SPS Commerce, Inc. Our principal executive offices are located at 333 South Seventh Street, Suite 1000, Minneapolis, Minnesota 55402, and our telephone number is (612) 435-9400. Our website address is www.spscommerce.com. Information on our website does not constitute part of this Annual Report on Form 10-K or any other report we file or furnish with the SEC. We provide free access to various reports that we file with or furnish to the SEC through our website as soon as reasonably practicable after they have been filed or furnished. These reports include, but are not limited to, our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and any amendments to these reports. Our SEC reports can be accessed through the investor relations section of our website or through the SEC's website at www.sec.gov. Stockholders may also request copies of these documents from:

SPS Commerce, Inc.

Attention: Investor Relations

333 South Seventh Street

Suite 1000

Minneapolis, MN 55402

Executive Officers

Set forth below are the names, ages and titles of the persons serving as our executive officers.

Name	Age	Position
Archie C. Black	56	Chief Executive Officer and President
Kimberly K. Nelson	51	Executive Vice President and Chief Financial Officer
James J. Frome	54	Executive Vice President and Chief Operating Officer

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Archie C. Black has served as our President and Chief Executive Officer and a director since 2001. Previously, Mr. Black served as our Senior Vice President and Chief Financial Officer from 1998 to 2001. Prior to joining us, Mr. Black was a Senior Vice President and Chief Financial Officer at Investment Advisors, Inc. in Minneapolis, Minnesota and also spent three years at Price Waterhouse.

Kimberly K. Nelson has served as our Executive Vice President and Chief Financial Officer since 2007. Prior to joining us, Ms. Nelson served as the Finance Director, Investor Relations for Amazon.com from 2005 through 2007 and as the Finance Director, Worldwide Application for Amazon.com's Technology group from 2003 until 2005. Ms. Nelson also served as Amazon.com's Finance Director, Financial Planning and Analysis from 2000 until 2003.

James J. Frome has served as our Executive Vice President and Chief Operating Officer since 2012. Previously, Mr. Frome served as our Executive Vice President and Chief Strategy Officer from 2001 to 2012 and as our Vice President of Marketing from 2000 to 2001. Prior to joining us, Mr. Frome served as a Divisional Vice President of Marketing at Sterling Software, Inc. from 1999 to 2000 and as a Senior Product Manager and Director of Product Management at Information Advantage, Inc. from 1993 to 1999.

Item 1A. Risk Factors

Set forth below and elsewhere in this Annual Report on Form 10-K, and in other documents we file with the SEC, are risks and uncertainties that could cause our actual results to differ materially from the results contemplated by the forward-looking statements contained in this Annual Report on Form 10-K and in other written and oral communications from time to time. You should carefully consider all of the following risks and the other information in this Report and our other filings with the SEC before you decide to invest in our Company or to maintain or increase your investment. Our business could be harmed by any of these risks. The trading price of our common stock could decline due to any of these risks. In assessing these risks, you should also refer to the other information contained in this Annual Report on Form 10-K, including our financial statements and related notes.

The risks included in this section are not the only ones we face. We operate in a very competitive and rapidly changing environment. New risk factors emerge from time-to-time, and it is not possible for management to predict all such risk factors, nor can it assess the potential impact of all such risk factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those in any forward-looking statements. If any of the following risks actually occur, our business, results of operations, financial condition and future prospects would likely suffer. In that case, the trading price of our common stock could decline, and you may lose all or part of your investment.

If we are unable to attract new customers, or sell additional solutions, or if our customers do not increase their use of our solutions, our revenue growth and profitability will be adversely affected.

To increase our revenues and achieve and maintain profitability, we must regularly add new customers, sell additional solutions and our customers must increase their use of the solutions for which they currently subscribe. We intend to grow our business by retaining and attracting talent, developing strategic relationships with resellers, including resellers that incorporate our applications in their offerings, and increasing our marketing activities. If we are unable to hire or retain quality personnel, convert companies that have been referred to us by our existing network into paying customers, ensure the effectiveness of our marketing programs, or if our existing or new customers do not perceive our solutions to be of sufficiently high value and quality, we might not be able to increase sales and our operating results will be adversely affected. If we fail to sell our new solutions to existing or new customers, we will not generate anticipated revenues from these solutions, our operating results will suffer and we might be unable to grow our revenues or maintain profitability.

We do not have long-term contracts with most of our recurring revenue customers, and our success therefore depends on our ability to maintain a high level of customer satisfaction and a strong reputation in the supply chain management industry.

Our contracts with our recurring revenue customers typically allow the customer to cancel the contract for any reason with 30 to 90 days' notice. Our continued success therefore depends significantly on our ability to meet or exceed our recurring revenue customers' expectations because most recurring revenue customers do not make long-term commitments to use our solutions. In addition, if our reputation in the supply chain management industry is harmed or diminished for any reason, our recurring revenue customers have the ability to terminate their relationship with us on short notice and seek alternative supply chain management solutions. We may also not be able to accurately predict future trends in customer renewals, and our customers' renewal rates may decline or fluctuate because of several factors, including their dissatisfaction with our services, the cost of our services compared to the cost of services offered by our competitors and reductions in our customers' spending levels. If a significant number of recurring revenue customers seek to terminate their relationship with us, our business, results of operations and financial condition can be adversely affected in a short period of time.

Our quarterly results of operations may fluctuate in the future, which could result in volatility in our stock price.

Our quarterly revenues and results of operations have varied in the past and may fluctuate as a result of a variety of factors, including our Trading Partner Analytics solution. If our quarterly revenues or results of operations fluctuate, the price of our common stock could decline substantially. Fluctuations in our results of operations may be due to a number of factors, including, but not limited to, those listed below and identified throughout this "Risk Factors" section:

- our ability to retain and increase sales to customers and attract new customers, including our ability to maintain and increase our number of recurring revenue customers;
- the timing and success of introductions of new solutions or upgrades by us or our competitors;
- the strength of the economy, in particular as it affects the retail sector;
- the financial condition of our customers;
- changes in our pricing policies or those of our competitors;
- competition, including entry into the industry by new competitors and new offerings by existing competitors;
- the amount and timing of our expenses, including stock-based compensation and expenditures related to expanding our operations, supporting new customers, performing research and development, or introducing new solutions;
- regulatory compliance costs and unforeseen legal expenses, including litigation and settlement costs;
- the timing, size, and integration success of potential future acquisitions;
- changes in the payment terms for our solutions; and
- system or service failures, security breaches or network downtime.

Due to the foregoing factors, and other risks including those discussed in this Annual Report on Form 10-K, comparing our operation results on a period-to-period basis may not be meaningful. You should not rely on these comparisons of our past results of operations as an indication of our future performance. It is possible that our operating results in one or more future quarters may fall below the expectations of securities analysts and investors or below any guidance we may provide to the market. If this occurs, the trading price of our common stock could decline significantly.

Interruptions or delays from third-party data centers or to the telecommunications infrastructure could impair the delivery of our solutions and our business could suffer.

We use third-party data centers, located in Minnesota, New Jersey and Australia, as well as provision services in public cloud providers, to conduct our operations. In all cases, infrastructure and services on which our Platform runs is managed by us. In addition, our ability to deliver our services depends on the development and maintenance of telecommunications infrastructure by third parties. This includes maintenance of a reliable network backbone with the necessary speed, data capacity, bandwidth capacity, and security. Our operations depend on the protection of the equipment and information we store in these third-party centers, or utilize from third-party telecommunications providers, against damage or service interruptions that may be caused by fire, flood, severe storm, power loss, telecommunications failures, natural disasters, war, criminal act, military action, terrorist attack, financial failure of the service provider, and other events beyond our control. In addition, third party malfeasance, such as intentional misconduct by computer hackers, unauthorized intrusions, computer viruses or denial of service attacks, may also cause substantial service disruptions. A prolonged service disruption affecting our solutions for any of the foregoing reasons could damage our reputation with current and potential customers, expose us to liability, cause us to lose recurring revenue customers or otherwise adversely affect our business. We may also incur significant costs for using alternative equipment or taking other actions in preparation for, or in reaction to, events that damage the data centers we use.

Our cloud-based supply chain management solutions are accessed by a large number of customers at the same time. As we continue to expand the number of our customers and solutions available to our customers, we may not be able to scale our technology to accommodate the increased capacity requirements, which may result in interruptions or delays in service. In addition, the failure of our third-party data centers to meet our capacity requirements could result in interruptions or delays in our solutions or impede our ability to scale our operations. In the event that our data center arrangements are terminated, or there is a lapse of service or damage to such facilities, we could experience interruptions in our solutions as well as delays and additional expense in arranging new facilities and services.

Our industry is a prime target for those that seek to steal confidential information and computer malware, viruses, hacking, phishing attacks, spamming, and other cyber-threats could harm our business and cause us to lose the confidence of our users, which could significantly impact our business and results of operations.

As demonstrated by recent material and high-profile data security breaches within the retail industry, computer malware, viruses, computer hacking, phishing attacks, social engineering, and other electronic threats have become more prevalent in our industry, have occurred on our systems in the past, and may occur on our systems in the future. While we continue to expand our focus on this issue and are taking measures to safeguard our solutions and services from cybersecurity threats and vulnerabilities, cyber-attacks and other security incidents continue to evolve in sophistication and frequency. Furthermore, given the interconnected nature of the retail supply chain and our significant presence in the retail industry, we believe that we are a particularly attractive target for such attacks. In addition, our connection to the retail industry could present the opportunity for an attack on our system to serve as a way to obtain access into our users' systems, which could have a material adverse effect on our financial condition and growth prospectus. Our security measures may also be breached due to employee or other error, intentional malfeasance and other third-party acts, and system errors or vulnerabilities, including vulnerabilities of our third party vendors, customers, or otherwise. Businesses in our industry have experienced material sales declines after discovering data breaches, and our business could be similarly impacted. The security costs to reduce the likelihood of an attack are high and may continue to increase. Furthermore, some US states and international jurisdictions have enacted laws requiring companies to notify consumers of data security breaches involving their personal data. These mandatory disclosures regarding a security breach often lead to widespread negative publicity, which may cause our customers to lose confidence in the effectiveness of our data security measures. Reputational value is based in large part on perceptions of subjective qualities. While reputations may take decades to build, any negative incidents can quickly erode trust and confidence, particularly if they result in adverse mainstream and social media publicity, governmental investigations or litigation. Though it is difficult to determine what, if any, harm may directly result from any specific interruption or attack, any failure to maintain performance, reliability, security and availability of our products and technical infrastructure to the satisfaction of our users may harm our reputation, impair our ability to retain existing customers and attract new customers and expose us to legal claims and government action, each of which could have a material adverse impact on our financial condition, results of operations and growth prospects.

A failure to protect the integrity and security of our customers' information and access to our customers' information systems could expose us to litigation, materially damage our reputation and harm our business, or lead to service disruptions, and the costs of preventing such a failure could adversely affect our results of operations.

Our business involves the collection and use of confidential information of our customers and their trading partners. The collection and use of this information sometimes requires our direct access to our customers' information systems. We cannot assure you that our efforts to protect this confidential information and access will be successful. Our security measures may be breached as a result of third-party action, including intentional misconduct by computer hackers, employee error, malfeasance or otherwise and result in someone obtaining unauthorized access to our customers' data or our data, including our intellectual property and other confidential business information, or our IT systems. Additionally, third parties may attempt to fraudulently induce employees or customers into disclosing sensitive information such as user names, passwords or other information in order to gain access to our customers' data or our data or IT systems. Because the techniques used to obtain unauthorized access, or to sabotage systems, change frequently and generally are not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures. Malicious third-parties may also conduct attacks designed to temporarily deny customers access to our services.

If any compromise of this information security were to occur, or if we fail to detect and appropriately respond to a significant data security breach, we could face service disruptions, be subject to legal claims and government action, experience an adverse effect on our reputation and need to incur significant additional costs to protect against similar information security breaches in the future, each of which could adversely impact our financial condition, results of operations and growth prospects. Litigation resulting from such claims may be costly, time-consuming and distracting to management. In addition, because of the critical nature of data security, any perceived breach of our security measures could cause existing or potential customers not to use our solutions and could harm our reputation.

We may experience service failures or interruptions due to defects in the hardware, software, infrastructure, third party components or processes that comprise our existing or new solutions, any of which could adversely affect our business.

Technology solutions as complex as ours may contain undetected defects in the hardware, software, infrastructure, third party components or processes that are part of the solutions we provide. If these defects lead to service failures, we could experience delays or lost revenues, diversion of software engineering resources, material non-monetary concessions, negative media attention or increased service costs as a result of performance claims during the period required to correct the cause of the defects. We cannot be certain that defects will not be found in new solutions or upgraded solutions, resulting in loss of, or delay in, market acceptance, which could have an adverse effect on our business, results of operations and financial condition.

Because customers use our cloud-based supply chain management solutions for critical business processes, any defect in our solutions, any disruption to our solutions or any error in execution could cause recurring revenue customers to cancel their contracts with us, prevent potential customers from joining our network and harm our reputation. Although most of our contracts with our customers limit our liability to our customers for these defects, disruptions or errors, we nonetheless could be subject to litigation for actual or alleged losses to our customers' businesses, which may require us to spend significant time and money in litigation or arbitration or to pay significant settlements or damages. We do not currently maintain any warranty reserves. Defending a lawsuit, regardless of its merit, could be costly and divert management's attention and could cause our business to suffer.

The insurers under our existing liability insurance policy could deny coverage of a future claim that results from an error or defect in our technology or a resulting disruption in our solutions, or our existing liability insurance might not be adequate to cover all of the damages and other costs of such a claim. Moreover, we cannot assure you that our current liability insurance coverage will continue to be available to us on acceptable terms or at all. The successful assertion against us of one or more large claims that exceeds our insurance coverage, or the occurrence of changes in our liability insurance policy, including an increase in premiums or imposition of large deductible or co-insurance requirements, could have an adverse effect on our business, financial condition and operating results. Even if we succeed in litigation with respect to a claim, we are likely to incur substantial costs and our management's attention will be diverted from our operations.

Our business is dependent on our ability to maintain and scale our technical infrastructure, and any failure to effectively maintain and grow our technical infrastructure service could damage our reputation, result in a potential loss of users and engagement, and adversely affect our financial results.

Our reputation and ability to attract, retain and serve our customers is dependent upon the reliable performance of our Platform and our underlying technical infrastructure. As our user base and the amount and types of information shared on our Platform continue to grow, we will need an increasing amount of technical infrastructure, including network capacity and computing power, to continue to satisfy the needs of our users. It is possible that we may fail to effectively scale and grow our technical infrastructure to accommodate these increased demands. Any failure to effectively maintain and grow our technical infrastructure could damage our reputation, result in a potential loss of users and engagement, and adversely affect our financial results.

Our inability to adapt to rapid technological change could impair our ability to remain competitive.

The industry in which we compete is characterized by rapid technological change, frequent introductions of new products and evolving industry standards. Existing products can become obsolete and unmarketable when vendors introduce products utilizing new technologies or new industry standards emerge, and as a result, it is difficult for us to estimate the life cycles of our products. Our ability to attract new customers and increase revenues from customers will depend in significant part on our ability to anticipate industry standards and to continue to enhance existing solutions or introduce or acquire new solutions on a timely basis to keep pace with technological developments. The success of any enhancement or new solution depends on several factors, including the timely completion, introduction and market acceptance of the enhancement or solution. Any new solution we develop or acquire might not be introduced in a timely or cost-effective manner and might not achieve the broad market acceptance necessary to generate significant revenues. If any of our competitors or new market entrants implement new technologies or upgrades to existing technologies before we are able to implement them, they may be able to provide more effective solutions than ours at lower prices. Any delay or failure in the introduction of new or enhanced solutions could adversely affect our business, results of operations and financial condition. Moreover, the development of new technologies requires substantial investment and we have no assurance that such investments will achieve their expected benefits on a timely manner or at all, either of which could have a material adverse effect on our results of operations.

If we fail to protect our intellectual property and proprietary rights adequately, our business could be adversely affected.

We believe that proprietary technology is essential to establishing and maintaining our leadership position. We seek to protect our intellectual property through trade secrets, copyrights, confidentiality, non-compete and nondisclosure agreements, trademarks, domain names and other measures, some of which afford only limited protection. We do not have any patents or registered copyrights. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our technology or to obtain and use information that we regard as proprietary. We cannot assure you that our means of protecting our proprietary rights will be adequate or that our competitors will not independently develop similar or superior technology or design around our intellectual property. In addition, the laws of some foreign countries do not protect our proprietary rights to as great an extent as the laws of the U.S. Intellectual property protections may also be unavailable, limited or difficult to enforce in some countries, which could make it easier for competitors to capture market share. Our failure to protect adequately our intellectual property and proprietary rights could adversely affect our business, financial condition and results of operations.

In addition, if we resort to legal proceedings to enforce our intellectual property rights or to determine the validity and scope of the intellectual property or other proprietary rights of others, the proceedings could be burdensome and expensive, even if we were to prevail. Any litigation that is necessary in the future could result in substantial costs and diversion of resources and could have a material adverse effect on our business, operating results or financial condition.

An assertion by a third party that we are infringing its intellectual property, whether or not correct, could subject us to costly and time-consuming litigation or expensive licenses and our business might be harmed.

The Internet supply chain management and technology industries are characterized by the existence of a large number of patents, copyrights, trademarks and trade secrets and by frequent litigation based on allegations of infringement or other violations of intellectual property rights. As we seek to extend our solutions, we could be constrained by the intellectual property rights of others.

We might not prevail in any intellectual property infringement litigation given the complex technical issues and inherent uncertainties in such litigation. Defending such claims, regardless of their merit, could be time-consuming and distracting to management, result in costly litigation or settlement, cause development delays, require us to enter into royalty or licensing agreements or require us to redesign our products to avoid infringement. If our solutions violate any third-party proprietary rights, we could be required to withdraw those solutions from the market, re-develop those solutions or seek to obtain licenses from third parties, which might not be available on reasonable terms or at all. Any efforts to re-develop our solutions, obtain licenses from third parties on favorable terms or license a substitute technology might not be successful and, in any case, might substantially increase our costs and harm our business, financial condition and operating results. Withdrawal of any of our solutions from the market might harm our business, financial condition and operating results. We face additional risk of infringement or misappropriation claims if we hire an employee who possess third party proprietary information who decides to use such information in connection with our solution, services, or business processes without such third party's authorization.

In addition, we incorporate open source software into our Platform. Given the nature of open source software, third parties might assert copyright and other intellectual property infringement claims against us based on our use of certain open source software programs. The terms of many open source licenses to which we are subject have not been interpreted by U.S. or foreign courts, and there is a risk that those licenses could be construed in a manner that imposes unanticipated conditions or restrictions on our ability to commercialize our solutions. In that event, we could be required to seek licenses from third parties in order to continue offering our solutions, to re-develop our solutions or to discontinue sales of our solutions, or to release our proprietary software code under the terms of an open source license, any of which could adversely affect our business.

Our new products and changes to existing products could fail to attract or retain users or generate revenue.

Our ability to retain, increase and engage our customers and to increase our revenues will depend heavily on our ability to create successful new products. We may introduce significant changes to our existing products or develop and introduce new and unproven products which include or use technologies with which we have little or no prior development or operating experience. If new or enhanced products fail to engage customers, we may fail to attract or retain customers or to generate sufficient revenues, operating margin, or other value to justify our investments and our business may be adversely affected. In the future, we may invest in new products and initiatives to generate revenue, but there is no guarantee these approaches will be successful. If we are not successful with new approaches to monetization, we may not be able to maintain or grow our revenues as anticipated or recover any associated development costs and our financial results could be adversely affected.

Our software is highly technical, and if it contains undetected errors, our business could be adversely affected.

Our products incorporate software that is highly technical and complex. Our software has contained, and may now or in the future contain, undetected errors, bugs or vulnerabilities. Some errors in our software code may only be discovered after the code has been released. Any defects or errors discovered in our code after release could result in damage to our reputation, loss of customers, loss of revenue or liability for damages, any of which could adversely affect our business and financial results.

The market for cloud-based supply chain management solutions is at an early stage of development. If this market does not develop or develops more slowly than we expect, our revenues may decline or fail to grow and we may incur operating losses.

We derive, and expect to continue to derive, substantially all of our revenues from providing cloud-based supply chain management solutions to suppliers, retailers, distributors and logistics firms. The market for cloud-based supply chain management solutions is in an early stage of development, and it is uncertain whether these solutions will achieve and sustain high levels of demand and market acceptance. Our success will depend on the willingness of retailers and their trading partners to accept our cloud-based supply chain management solutions as an alternative to traditional licensed hardware and software solutions.

Some suppliers, retailers, distributors, or logistics firms may be reluctant or unwilling to use our cloud-based supply chain management solutions for a number of reasons, including existing investments in supply chain management technology. Supply chain management functions traditionally have been performed using purchased or licensed hardware and software implemented by each supplier. Because this traditional approach often requires significant initial investments to purchase the necessary technology and to establish systems that comply with retailers' unique requirements, suppliers may be unwilling to abandon their current solutions for our cloud-based supply chain management solutions.

Other factors that may limit market acceptance of our cloud-based supply chain management solutions include:

- our ability to maintain high levels of customer satisfaction;
- our ability to maintain continuity of service for all users of our Platform;
- the price, performance and availability of competing solutions; and
- our ability to assuage suppliers' confidentiality concerns about information stored outside of their controlled computing environments.

If retailers and their trading partners do not perceive the benefits of our cloud-based supply chain management solutions, or if retailers and their trading partners are unwilling to accept our Platform as an alternative to the traditional approach, the market for our solutions might not continue to develop or might develop more slowly than we expect, either of which would significantly adversely affect our revenues and growth prospects.

Privacy concerns and laws, evolving regulation of cloud computing, cross-border data transfer restrictions and other domestic or foreign regulations may limit the use and adoption of our solutions and adversely affect our business.

Regulation related to the provision of services on the Internet is increasing, as federal, state and foreign governments continue to adopt new laws and regulations addressing data privacy and the collection, processing, storage and use of personal information. In some cases, foreign data privacy laws and regulations, such as the European Union's Data Protection Directive, and the country-specific regulations that implement that directive, also govern the processing of personal information. Further, laws are increasingly aimed at the use of personal information for marketing purposes, such as the European Union's e-Privacy Directive, and the country-specific regulations that implement that directive. Such laws and regulations are subject to differing interpretations and may be inconsistent among jurisdictions. These and other requirements could reduce demand for our solutions or restrict our ability to store and process data or, in some cases, impact our ability to offer our services and solutions in certain locations.

In addition to government activity, privacy advocacy and other industry groups have established or may establish new self-regulatory standards that may place additional burdens on us. Our customers may expect us to meet voluntary certification or other standards established by third parties. If we are unable to maintain these certifications or meet these standards, it could adversely affect our ability to provide our solutions to certain customers and could harm our business.

The costs of compliance with and other burdens imposed by laws, regulations and standards may limit the use and adoption of our services and reduce overall demand for them, or lead to significant fines, penalties or liabilities for any noncompliance.

Furthermore, concerns regarding data privacy may cause our customers' customers to resist providing the data necessary to allow our customers to use our service effectively. Even the perception that the privacy of personal information is not satisfactorily protected or does not meet regulatory requirements could inhibit sales of our products or services and could limit adoption of our cloud-based solutions.

Evolving regulation of the Internet may increase our expenditures related to compliance efforts, which may adversely affect our financial condition.

As Internet commerce continues to evolve, increasing regulation by federal, state or foreign agencies becomes more likely. We are particularly sensitive to these risks because the Internet is a critical component of our cloud-based business model. For example, we believe that increased regulation is likely in the area of data privacy, and laws and regulations applying to the solicitation, collection, processing or use of personal or consumer information could affect our customers' ability to use and share data, potentially reducing demand for solutions accessed via the Internet and restricting our ability to store, process and share data with our clients via the Internet. In addition, taxation of services provided over the Internet or other charges imposed by government agencies or by private organizations for accessing the Internet may be imposed. Any regulation imposing greater fees for Internet use or restricting information exchange over the Internet could result in a decline in the use of the Internet and the viability of Internet-based services, which could harm our business.

Industry-specific regulation is evolving and unfavorable industry-specific laws, regulations or interpretive positions could harm our business.

Our customers and potential customers do business in a variety of industries. Regulators in certain industries have adopted and may in the future adopt regulations or interpretive positions regarding the use of cloud computing and other outsourced services. The costs of compliance with, and other burdens imposed by, industry-specific laws, regulations and interpretive positions may limit customers' use and adoption of our services and reduce overall demand for our services. In addition, an inability to satisfy the standards of certain voluntary third-party certification bodies that our customers may expect may have an adverse impact on our business. If in the future we are unable to achieve or maintain these industry-specific certifications or other requirements or standards relevant to our customers, it may harm our business.

In some cases, industry-specific laws, regulations or interpretive positions may also apply directly to us as a service provider. Any failure or perceived failure by us to comply with such requirements could have an adverse impact on our business.

We rely on third party infrastructure, software and services that could take a significant time to replace or upgrade.

We rely on infrastructure, software and services licensed from third parties to offer our cloud-based supply chain management solutions. This infrastructure, software and services, as well as maintenance rights for this infrastructure, software and services, may not continue to be available to us on commercially reasonable terms, or at all. If we lose the right to use or upgrade any of these licenses, our customers could experience delays or be unable to access our solutions until we can obtain and integrate equivalent technology. There might not always be commercially reasonable hardware or software alternatives to the third-party infrastructure, software and services that we currently license. Any such alternatives could be more difficult or costly to replace than the third-party infrastructure, software and services we currently license, and integration of the alternatives into our Platform could require significant work and substantial time and resources. Any delays or failures associated with our Platform could injure our reputation with customers and potential customers and result in an adverse effect on our business, results of operations and financial condition.

We may pursue acquisitions and our potential inability to successfully integrate newly acquired companies or businesses could adversely affect our financial results.

We may pursue acquisitions of other companies or their businesses in the future. If we complete acquisitions, we face many risks commonly encountered with growth through acquisitions. These risks include:

- incurring significantly higher than anticipated capital expenditures and operating expenses;
- failing to assimilate the operations, customers, and personnel of the acquired company or business;
- disrupting our ongoing business;
- dissipating our management resources;

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- dilution to existing stockholders from the issuance of equity securities;
- liabilities or other problems associated with the acquired business;
- incurring debt on terms unfavorable to us or that we are unable to repay;
- becoming subject to adverse tax consequences, substantial depreciation or deferred compensation charges;
- improper compliance with laws and regulations;
- failing to maintain uniform standards, controls and policies; and
- impairing relationships with employees and customers as a result of changes in management.

Fully integrating an acquired company or business into our operations may take a significant amount of time. In addition, we may only be able to conduct limited due diligence on an acquired company's operations. Following an acquisition, we may be subject to liabilities arising from an acquired company's past or present operations, including liabilities related to data security, encryption and privacy of customer data, and these liabilities may be greater than the warranty and indemnity limitations that we negotiate. We cannot assure you that we will be successful in overcoming these risks or any other problems encountered with acquisitions. To the extent we do not successfully avoid or overcome the risks or problems related to any acquisitions, our results of operations and financial condition could be adversely affected. Future acquisitions also could impact our financial position and capital needs, and could cause substantial fluctuations in our quarterly and yearly results of operations. Acquisitions could include significant goodwill and intangible assets, which may result in future impairment charges that would reduce our stated earnings.

Because our long-term success depends, in part, on our ability to expand the sales of our solutions to customers located outside of North America, our business will be susceptible to risks associated with international operations.

Our inexperience in operating our business outside of North America increases the risk that our current and any future international expansion efforts will not be successful. Conducting international operations subjects us to new risks that, generally, we have not faced in the U.S., including:

- misjudging the markets and competitive landscape of foreign jurisdictions;
- fluctuations in currency exchange rates;
- unexpected changes in foreign regulatory requirements;
- longer accounts receivable payment cycles and difficulties in collecting accounts receivable;
- difficulties in managing and staffing international operations;
- differing technology standards;
- potentially adverse tax consequences, including the complexities of foreign value added tax systems and restrictions on the repatriation of earnings;
- localization of our solutions, including translation into foreign languages and associated expenses;
- the burdens of complying with a wide variety of foreign laws and different legal standards, including laws and regulations related to privacy;
- increased financial accounting and reporting burdens and complexities;
- political, social and economic instability abroad, terrorist attacks and security concerns in general;
- greater potential for corruption and bribery; and
- reduced or varied protection for intellectual property rights in some countries.

The occurrence of any one of these risks could negatively affect our international business and, consequently, our results of operations generally. Additionally, operating in international markets also requires significant management attention and financial resources. We cannot be certain that the investment and additional resources required in establishing, acquiring or integrating operations in other countries will produce desired levels of revenues or profitability.

In addition, we operate in parts of the world, such as Ukraine, that are recognized as having governmental corruption problems to some degree and where local customs and practices may not foster strict compliance with anti-corruption laws. Our continued operation and potential expansion outside the U.S. could increase the risk of such violations in the future. Despite our training and compliance programs, we cannot assure you that our internal control policies and procedures will protect us from unauthorized reckless or criminal acts committed by our employees or agents, including by third parties we utilize in foreign jurisdictions. In the event that we believe, or have reason to believe, that our employees or agents have or may have violated applicable anti-corruption laws, including the U.S. Foreign Corrupt Practices Act, we may be required to investigate or have outside counsel investigate the relevant facts and circumstances, which can be expensive and require significant time and attention from senior management. Violations of these laws may result in severe criminal or civil sanctions, which could disrupt our business and result in a material adverse effect on our reputation, business, results of operations or financial condition.

The use of open source software in our products may expose us to additional risks and harm our intellectual property.

Some of our products use or incorporate software that is subject to one or more open source licenses. Open source software is typically freely accessible, usable and modifiable. Certain open source software licenses require a user who intends to distribute the open source software as a component of the user's software to disclose publicly part or all of the source code to the user's software. In addition, certain open source software licenses require the user of such software to make any derivative works of the open source code available to others on unfavorable terms or at no cost. This can subject previously proprietary software to open source license terms. Furthermore, if we fail to comply with these licenses, we may be subject to certain unfavorable requirements. These requirements may include, but are not limited to, offering our services that incorporate the open source software for no cost, making available any of our modifications to the source code, making available any derivative works we create based upon, incorporating, or using the open source software, or licensing such modifications or derivative works under the terms of the particular open source license. If an author or third party that distributes such open source software were to allege that we had not complied with the conditions of one or more of these licenses, we could be required to incur significant legal expenses defending against such allegations and could be subject to significant damages, enjoined from the sale of our services that contained the open source software and required to comply with the foregoing conditions, which could disrupt the distribution and sale of some of our services.

While we monitor the use of all open source software in our products, processes and technology and try to ensure that no open source software is used in such a way as to require us to disclose the source code to the related product or solution, such use could inadvertently occur. Additionally, if a third-party software provider has incorporated certain types of open source software into software we license from such third party for our products and solutions, we could, under certain circumstances, be required to disclose the source code to our products and solutions. This could harm our intellectual property position and have a material adverse effect on our business, results of operations, cash flow and financial condition.

Our operations may be adversely affected by ongoing developments in Ukraine.

The political and civil situation in Ukraine cannot be accurately predicted since the removal of President Yanukovych from power by the Ukrainian parliament in late February 2014, which was followed by reports of Russian military activity in the Crimean region. Ukraine's political activities remain fluid and beyond our control. We also cannot predict the outcome of developments there or the reaction to such developments by U.S., European, U.N. or other international authorities.

We currently engage in software development activities in the Ukraine and have an office in Kiev. We continue to monitor the situation closely. Prolonged or expanded unrest, military activities, or broad-based sanctions, should they be implemented, could have a material adverse effect on our operations

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We have incurred operating losses in the past and may incur operating losses in the future.

We began operating our supply chain management solution business in 1997. Throughout most of our history, we have experienced net losses and negative cash flows from operations. As of December 31, 2018, we had retained earnings of $15.3 million compared to an accumulated deficit of $8.6 million as of December 31, 2017. We expect our operating expenses to continue to increase in the future as we expand our operations and increase our customer base due to expected increased sales and marketing expenses, operations costs, research and development costs and general and administration costs. If our revenues do not continue to grow to offset these increased expenses, we may not be profitable. We cannot assure you that we will be able to maintain profitability. You should not consider recent revenue growth as indicative of our future performance. In fact, in future periods, we may not have any revenue growth, or our revenues could decline. In addition, our ability to achieve profitability is subject to a number of the risks and uncertainties, including those discussed herein, many of which are beyond our control.

Our ability to use our U.S. net operating loss carryforwards might be limited.

As of December 31, 2018, we had net operating loss carryforwards of $37.5 million for U.S. federal tax purposes. We also had $3.2 million of various state net operating loss carryforwards. The net operating loss carryforwards for federal tax purposes will expire between 2020 and 2038 if not utilized. The net operating loss carryforwards for state tax purposes will expire between 2019 and 2031 if not utilized. To the extent these net operating loss carryforwards are available, we intend to use them to reduce the corporate income tax liability associated with our operations. Section 382 of the U.S. Internal Revenue Code generally imposes an annual limitation on the amount of net operating loss carryforwards that might be used to offset taxable income when a corporation has undergone significant changes in stock ownership. We have performed a Section 382 analysis for the time period from our inception through December 8, 2010. During this time period, it was determined that we had six separate ownership changes under Section 382. We have not updated the Section 382 analysis subsequent to December 8, 2010; however, we believe there have not been any events subsequent to that date that would materially impact the analysis. We believe that approximately $17.6 million of federal losses will expire unused due to Section 382 limitations. The maximum annual limitation of federal net operating losses under Section 382 is approximately $1.0 million. This limitation could be further restricted if any ownership changes occur in future years. To the extent our use of net operating loss carryforwards is significantly limited, our taxable income could be subject to corporate income tax earlier than it would if we were able to use net operating loss carryforwards, which could result in lower profits.

Unanticipated changes in effective tax rates or adverse outcomes resulting from examination of our income or other tax returns could adversely affect our operating results and financial condition.

We are subject to income taxes in the U.S. and various foreign jurisdictions, and our domestic and international tax liabilities will be subject to the allocation of expenses in differing jurisdictions. Our future effective tax rates could be subject to volatility or adversely affected by a number of factors, including:

- changes in the valuation of our deferred tax assets and liabilities
- expected timing and amount of the release of tax valuation allowances
- expiration of, or detrimental changes in, research and development tax credit laws;
- tax effects of stock-based compensation;
- costs related to intercompany restructurings;
- changes in tax laws, regulations, accounting principles or interpretations thereof; and
- future earnings being lower than anticipated in countries where we have lower statutory tax rates and higher than anticipated earnings in countries where we have higher statutory tax rates.

In addition, we may be subject to audits of our income and sales taxes by the Internal Revenue Service and other foreign and state tax authorities. Outcomes from these audits could have an adverse effect on our operating results and financial condition.

The markets in which we participate are highly competitive, and our failure to compete successfully would make it difficult for us to add and retain customers and would reduce or impede the growth of our business.

The markets for supply chain management solutions are increasingly competitive and global. We expect competition to increase in the future both from existing competitors and new companies that may enter our markets. Increased competition could result in pricing pressure, reduced sales, lower margins or the failure of our solutions to achieve or maintain broad market acceptance. We face competition from:

- cloud service providers that deliver business-to-business information systems using a multi-tenant approach;
- traditional on-premise software providers; and
- managed service providers that combine traditional on-premise software with professional information technology services.

To remain competitive, we will need to invest continuously in software development, marketing, customer service and support and product delivery infrastructure. However, we cannot assure you that new or established competitors will not offer solutions that are superior to or lower in price than ours. We may not have sufficient resources to continue the investments in all areas of software development and marketing needed to maintain our competitive position. In addition, some of our competitors are better capitalized than us, which may provide them with an advantage in developing, marketing or servicing new solutions. Increased competition could reduce our market share, revenues and operating margins, increase our costs of operations and otherwise adversely affect our business.

Mergers or other strategic transactions involving our competitors could weaken our competitive position, which could harm our operating results.

Our industry is highly fragmented, and we believe it is likely that our existing competitors will continue to consolidate or will be acquired. In addition, some of our competitors may enter into new alliances with each other or may establish or strengthen cooperative relationships with systems integrators, third-party consulting firms or other parties. New entrants not currently considered to be competitors may also enter the market through acquisitions, partnerships, or strategic relationships. Any such consolidation, acquisition, alliance or cooperative relationship could lead to pricing pressure, loss of customers and our loss of market share and could result in a competitor with greater financial, technical, marketing, service and other resources, all of which could have a material adverse effect on our business, operating results and financial condition.

Economic weakness and uncertainty could adversely affect our revenue, lengthen our sales cycles and make it difficult for us to forecast operating results accurately.

Our revenues depend significantly on general economic conditions and the health of retailers. Economic weakness and constrained retail spending adversely affected revenue growth rates in late 2008 and similar circumstances may result in slower growth, or reductions, in revenues and gross profits in the future. We have experienced, and may experience in the future, reduced spending in our business due to financial turmoil affecting the U.S. and global economy, and other macroeconomic factors affecting spending behavior. Uncertainty about future economic conditions makes it difficult for us to forecast operating results and to make decisions about future investments. In addition, economic conditions or uncertainty may cause customers and potential customers to reduce or delay technology purchases, including purchases of our solutions. Our sales cycle may lengthen if purchasing decisions are delayed as a result of uncertain information technology or development budgets or contract negotiations become more protracted or difficult as customers institute additional internal approvals for information technology purchases. Delays or reductions in information technology spending could have a material adverse effect on demand for our solutions, and consequently our results of operations, prospects and stock price.

Our continued growth could strain our personnel resources and infrastructure, and if we are unable to implement appropriate controls and procedures to manage our growth, we will not be able to implement our business plan successfully.

We have experienced a period of rapid growth in our headcount and operations. To the extent that we are able to sustain such growth, it might place a significant strain on our management, administrative, operational and financial infrastructure. Our success will depend in part upon the ability of our senior management to manage this growth effectively. To do so, we must continue to hire, train and manage new employees as needed. If our new hires perform poorly, if we are unsuccessful in hiring, training, managing and integrating these new employees, if we are not successful in retaining our existing employees, or if our culture is adversely affected by any of the foregoing, our business would be harmed. To manage the expected growth of our operations and personnel, we will need to continue to improve our operational, financial and management controls and our reporting systems and procedures. The additional headcount we are adding will increase our cost base, which will make it more difficult for us to offset any future revenue shortfalls by reducing expenses in the short term. If we fail to successfully manage our growth, we will be unable to execute our business plan.

If we fail to retain our Chief Executive Officer and other key personnel, our business would be harmed and we might not be able to implement our business plan successfully.

Given the complex nature of the technology on which our business is based and the speed with which such technology advances, our future success is dependent, in large part, upon our ability to attract and retain highly qualified managerial, technical and sales personnel. The loss of any member of our senior management team or key personnel might significantly delay or prevent the achievement of our business objectives and could materially harm our business and our customer relationships. In addition, because of the nature of our business, the loss of any significant number of our existing engineering, project management and sales personnel could have an adverse effect on our business, results of operations and financial condition. Competition for talented personnel is intense, and we cannot be certain that we can retain our managerial, technical and sales personnel or that we can attract, assimilate or retain such personnel in the future. Our inability to attract and retain such personnel could have an adverse effect on our business, results of operations and financial condition.

Our failure to maintain adequate internal control over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act of 2002 or to prevent or detect material misstatements in our annual or interim financial statements in the future could result in inaccurate financial reporting, or could otherwise harm our business and stock price.

Ensuring that we have internal financial and accounting controls and procedures adequate to produce accurate financial statements on a timely basis is a costly and time-consuming effort that needs to be re-evaluated frequently. The Sarbanes-Oxley Act requires, among other things, that we maintain effective internal control over financial reporting and disclosure controls and procedures. In particular, we are required to perform annual system and process evaluation and testing of our internal control over financial reporting to allow management and our independent registered public accounting firm to report on the effectiveness of our internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act. Furthermore, implementing any appropriate future changes to our internal control over financial reporting may entail substantial costs in order to modify our existing accounting systems, may take a significant period of time to complete and may distract our officers, directors and employees from the operation of our business. If we are not able to comply with the requirements of Section 404 in the future, or if material weaknesses are identified, the market price of our common stock could decline.

Our failure to raise additional capital or generate cash flows necessary to expand our operations and invest in new technologies could reduce our ability to compete successfully and adversely affect our results of operations.

We may need to raise additional funds, and we may not be able to obtain additional debt or equity financing on favorable terms, if at all. If we raise additional equity financing, our security holders may experience significant dilution of their ownership interests and the value of shares of our common stock could decline. If we engage in debt financing, we may be required to accept terms that restrict our ability to incur additional indebtedness, force us to maintain specified liquidity or other ratios or restrict our ability to pay dividends or make acquisitions. If we need additional capital and cannot raise it on acceptable terms, we may not be able to, among other things:

- develop and enhance our solutions;
- continue to expand our technology development, sales and marketing organizations;
- acquire complementary technologies, products or businesses;
- hire, train and retain employees; or
- respond to competitive pressures or unanticipated working capital requirements.

Our inability to do any of the foregoing could reduce our ability to compete successfully and adversely affect our results of operations.

If open source, or other no-cost products and services, expand into enterprise application and supply chain software, our fee revenues may decline.

The open source community is comprised of many different formal and informal groups of software developers and individuals who have created a wide variety of software and have made that software available for use, distribution and modification, often free of charge. Open source software, such as the Linux operating system, has been gaining in popularity among business users. If developers contribute enterprise and supply chain application software to the open source community, or if competitors make such software available at no cost, and that software has competitive features and scale to support business users in our markets, we may need to change our product pricing and distribution strategy to compete successfully, and our fee revenues may decline as a result.

Our stock price may be volatile.

Shares of our common stock were sold in our April 2010 initial public offering at a price of $12.00 per share and through December 31, 2018, our common stock has traded as high as $100.68 per share and as low as $8.45 per share. An active, liquid and orderly market for our common stock may not be sustained, which could depress the trading price of our common stock. Some of the factors that may cause the market price of our common stock to fluctuate include:

- fluctuations in our quarterly financial results or the quarterly financial results of companies perceived to be similar to us;
- fluctuations in our recorded revenue, even during periods of significant sales order activity;
- fluctuations in stock market volume;
- changes in estimates of our financial results or recommendations by securities analysts;
- failure of any of our solutions to achieve or maintain market acceptance;
- changes in market valuations of similar companies;
- success of competitive products or services;
- changes in our capital structure, such as future issuances of securities or the incurrence of debt;
- announcements by us or our competitors of significant solutions, contracts, acquisitions or strategic alliances;

- regulatory developments in the United States of America, foreign countries or both;
- litigation involving our company, our general industry or both;
- additions or departures of key personnel;
- investors' general perception of us; and
- changes in general economic, industry and market conditions.

In addition, if the market for software stocks or the stock market in general experiences a loss of investor confidence, the trading price of our common stock could decline for reasons unrelated to our business, financial condition or results of operations. If any of the foregoing occurs, it could cause our stock price to fall and may expose us to class action lawsuits that, even if unsuccessful, could be costly to defend and a distraction to management.

If securities or industry analysts cease publishing research or reports about us, our business or our market, or if they publish negative evaluations of our stock, the price of our stock and trading volume could decline.

The trading market for our common stock depends in part on the research and reports that securities or industry analysts publish about us or our business. If one or more of the analysts who covers us downgrades our stock or publishes incorrect or unfavorable research about our business, our stock price would likely decline. In addition, if one or more of these analysts ceases coverage of our company or fails to publish reports on us regularly, demand for our stock could decrease, which could cause our stock price or trading volume to decline.

Future sales of our common stock by our existing stockholders could cause our stock price to decline.

If our stockholders sell substantial amounts of our common stock in the public market, the market price of our common stock could decrease significantly. The perception in the public market that our stockholders might sell shares of our common stock could also depress the market price of our common stock. As of December 31, 2018, we had approximately 5.3 million shares of our common stock issuable under approved equity compensation plans which are covered by effective registration statements.

Our charter documents and Delaware law may delay, discourage, or inhibit a takeover that stockholders consider favorable.

Provisions of our certificate of incorporation and bylaws and applicable provisions of Delaware law may delay, discourage, or inhibit transactions involving an actual or potential change in our control or change in our management, including transactions in which stockholders might otherwise receive a premium for their shares, or transactions that our stockholders might otherwise deem to be in their best interests, and may ultimately result in the market price of our common stock being lower than it would be without these provisions. These provisions:

- permit our board of directors to issue up to 5,000,000 shares of preferred stock, with any rights, preferences and privileges as our board may designate, including the right to approve an acquisition or other change in our control;
- provide that the authorized number of directors may be changed by resolution of the board of directors;
- provide that all vacancies, including newly created directorships, may, except as otherwise required by law, be filled by the affirmative vote of a majority of directors then in office, even if less than a quorum;
- provide that stockholders seeking to present proposals before a meeting of stockholders or to nominate candidates for election as directors at a meeting of stockholders must provide notice in writing in a timely manner, and also specify requirements as to the form and content of a stockholder's notice; and
- do not provide for cumulative voting rights.

In addition, Section 203 of the Delaware General Corporation Law generally limits our ability to engage in any business combination with certain persons who own 15% or more of our outstanding voting stock or any of our associates or affiliates who at any time in the past three years have owned 15% or more of our outstanding voting stock. These provisions may have the effect of entrenching our management team and may deprive you of the opportunity to sell your shares to potential acquirers at a premium over prevailing prices. This potential inability to obtain a control premium could reduce the price of our common stock.

We do not intend to declare dividends on our stock in the foreseeable future.

We currently intend to retain all future earnings for the operation and expansion of our business and, therefore, do not anticipate declaring or paying cash dividends on our common stock in the foreseeable future. Investors may need to sell all or part of their holdings of our common stock after price appreciation, which may never occur, as the only way to realize any future gains on their investment. Any payment of future cash dividends on our common stock will be at the discretion of our board of directors and will depend upon our results of operations, earnings, capital requirements, financial condition, future prospects, contractual restrictions and other factors deemed relevant by our board of directors. Therefore, you should not expect to receive dividend income from shares of our common stock.

Item 1B. Unresolved Staff Comments
None.

Item 2. Properties
Our corporate headquarters, including our principal administrative, marketing, sales, technical support and research and development facilities, are located in Minneapolis, Minnesota where we lease approximately 189,000 square feet under an agreement that expires on April 30, 2025. We have agreed to expand our headquarters premises by approximately 25,000 square feet during 2020. Our lease agreement also includes a further expansion right and a right of first offer to lease certain additional space and two options to extend the term of the lease for five years at a market rate determined in accordance with the lease.

We also have operations in or near:

- Little Falls, New Jersey, where we lease approximately 26,000 square feet under an agreement that expires on June 30, 2023. The lease includes a right of first offer to lease certain additional space and one option to extend the term of the lease for five years at a market rate determined in accordance with the lease.
- Toronto, Ontario, where we lease approximately 17,000 square feet under an agreement that expires on December 31, 2021. The lease includes a right of first offer to lease certain additional space and one option to extend the term of the lease for five years at a market rate determined in accordance with the lease.
- Melbourne, Australia, where we lease approximately 11,000 square feet under an agreement that expires on October 15, 2021. The lease includes one option to extend the term of the lease for three years at a market rate determined in accordance with the lease.
- Houston, Texas, where we lease approximately 4,600 square feet under an agreement that expires on January 31, 2022. The lease includes a right of first offer to lease certain additional spaces and one option to extend the term of the lease for up to three years at a market rate determined in accordance with the lease.
- Sydney, Australia, where we lease approximately 4,000 square feet under an agreement that expires on April 30, 2020. The lease includes a right of first offer to lease certain additional space and one option to extend the term of the lease for three years at a market rate determined in accordance with the lease.
- Kiev, Ukraine, where we lease approximately 3,000 square feet under an agreement that expires on April 26, 2020. The lease includes one option to extend the term of the lease for two years and 11 months at a market rate determined in accordance with the lease.

We believe that our current facilities are suitable and adequate to meet our current needs and that suitable additional or substitute space will be available as needed to accommodate expansion of our operations.

Item 3. Legal Proceedings

We are not currently subject to any material legal proceedings. From time to time, we may be named as a defendant in legal actions or otherwise be subject to claims arising from our normal business activities. We believe that we have obtained adequate insurance coverage or rights to indemnification in connection with potential legal proceedings that may arise.

Item 4. Mine Safety Disclosures

Not applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market Information. Our common stock has traded on the Nasdaq Global Market under the symbol "SPSC" since April 22, 2010, the date of our initial public offering. The following table sets forth, for the periods indicated, the high and low sales prices for our common stock as reported on the Nasdaq Global Market.

Stockholders of Record. As of February 8, 2019, we had 76 stockholders of record of our common stock, excluding holders whose stock is held either in nominee name and/or street name brokerage accounts.

Dividends. We have not historically paid dividends on our common stock. We currently intend to retain our future earnings, if any, to finance the operation and expansion of our business, and, therefore, we do not expect to pay cash dividends on our common stock in the foreseeable future. Payment of future cash dividends, if any, will be at the discretion of our board of directors after taking into account various factors, including our financial condition, operating results, current and anticipated cash needs, outstanding indebtedness and plans for expansion and restrictions imposed by lenders, if any.

Stock Performance Graph and Cumulative Total Return

Notwithstanding any statement to the contrary in any of our previous or future filings with the SEC, the following information relating to the price performance of our common stock shall not be deemed to be "filed" with the SEC or to be "soliciting material" under the Securities Exchange Act of 1934, as amended, ("Exchange Act"), and it shall not be deemed to be incorporated by reference into any of our filings under the ("Securities Act") of 1933, as amended, or the Securities Act, or the Exchange Act, except to the extent we specifically incorporate it by reference into such filing.

The graph below compares the cumulative total stockholder return of our common stock with that of the Nasdaq US Benchmark TR Index and the Nasdaq US Benchmark Computer Services TR Index from December 31, 2013 through December 31, 2018, utilizing the last trading day of each respective year. The graph assumes that $100 was invested in shares of our common stock, the Nasdaq US Benchmark TR Index and the Nasdaq US Benchmark Computer Services TR Index at the close of market on December 31, 2013, and that dividends, if any, were reinvested. The comparisons in this graph are based on historical data and are not intended to forecast or be indicative of future performance of our common stock.

Comparison of Cumulative Total Returns of SPS Commerce, Inc., Nasdaq US Benchmark TR Index and

Nasdaq US Benchmark Computer Services TR Index

	SPS Commerce	Nasdaq US Benchmark TR Index	Nasdaq US Benchmark Computer Services TR Index
12/31/2013	100.0	100.0	100.0
12/31/2014	86.7	112.5	95.2
12/31/2015	107.5	113.0	93.2
12/30/2016	107.0	127.7	149.3
12/29/2017	74.4	155.0	120.9
12/31/2018	126.2	146.6	110.6

Recent Sales of Unregistered Securities; Use of Proceeds from Sales of Registered Securities

Not applicable.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

On November 2, 2017, our board of directors authorized a program to repurchase up to $50.0 million of common stock. Under the program, purchases may be made from time to time in the open market over two years. We repurchased 289,745 shares at a cost of $19.9 million and 122,147 shares at a cost of $5.8 million for the years ended December 31, 2018 and 2017, respectively. As of December 31, 2018, $24.3 million of the $50.0 million of the share repurchases authorized was available for future share repurchases.

The following table presents the total number of shares of our common stock that we purchased during the fourth quarter of 2018, the average price paid per share, the number of shares that we purchased as part of our publicly announced repurchase program and the approximate dollar value of shares that still could be repurchased at the end of the applicable period.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Approximate Dollar Value of Shares that May Yet be Purchased Under the Program
October 1-31, 2018	70,100	$ 85.59	70,100	$ 24,300,000
November 1-30, 2018	—	—	—	24,300,000
December 1 - 31, 2018	—	—	—	24,300,000
Total fourth quarter 2018	70,100	$ 85.59	70,100	$ 24,300,000

See Note K to our consolidated financial statements, included in this Annual Report on Form 10-K, for additional information regarding our stock repurchase program.

Item 6. Selected Financial Data

The following selected financial data should be read together with our audited consolidated financial statements and the related notes and with "Management's Discussion and Analysis of Financial Condition and Results of Operations" which are included elsewhere in this Annual Report on Form 10-K. Our historical results are not necessarily indicative of results to be expected for any future period.

The statements of income data for each of the years ended December 31, 2018, 2017 and 2016, the balance sheet data as of December 31, 2018 and 2017, and the operating data relating to Adjusted EBITDA and non-GAAP income per diluted share for each of the years ended December 31, 2018, 2017, and 2016 have been derived from our audited consolidated financial statements, which are included in this Annual Report on Form 10-K.

The statements of income data for the years ended December 31, 2015, and 2014, the balance sheet data as of December 31, 2016, 2015 and 2014, and the operating data relating to Adjusted EBITDA and non-GAAP income per diluted share for each of the years ended December 31, 2015 and 2014 have been derived from our audited consolidated financial statements which are not included in this Annual Report on Form 10-K, but which have been included in prior Annual Reports on Form 10-K filed with the SEC. These statements do not reflect our adoption of Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606) and Other Assets and Deferred Costs – Contracts with Customers (Subtopic 340-40).

Adjusted EBITDA and non-GAAP income per diluted share are non-GAAP financial measures. We believe that these non-GAAP measures provide useful information to management and investors regarding certain financial and business trends relating to our financial condition and results of operations. Our management uses these non-GAAP measures to compare the company's performance to that of prior periods for trend analyses and planning purposes. Adjusted EBITDA is also used for purposes of determining executive and senior management incentive compensation. These measures are also presented to our board of directors.

These non-GAAP measures should not be considered a substitute for, or superior to, financial measures calculated in accordance with generally accepted accounting principles in the United States of America ("GAAP"). These non-GAAP financial measures exclude significant expenses and income that are required by GAAP to be recorded in the company's financial statements and are subject to inherent limitations. Investors should review the reconciliations of these non-GAAP financial measures to the comparable GAAP financial measures that are included below.

The operating data relating to recurring revenue customers for all periods presented is unaudited and has been derived from our internal records of our operations.

	Year Ended December 31,				
	2018	2017	2016	2015	2014
	(In thousands, except per share data)				
Statements of Income Data					
Revenues	$248,240	$220,085	$193,153	$158,518	$127,947
Cost of revenues (1)	81,748	$73,625	$64,346	50,043	39,991
Gross profit	166,492	146,460	128,807	108,475	87,956
Operating expenses					
Sales and marketing (1)	71,719	71,261	66,876	55,374	46,990
Research and development (1)	22,087	23,183	21,981	17,954	13,494
General and administrative (1)	41,862	37,461	28,827	24,817	20,233
Amortization of intangible assets	4,093	4,574	4,738	3,307	2,856
Total operating expenses	139,761	136,479	122,422	101,452	83,573
Income from operations	26,731	9,981	6,385	7,023	4,383
Other income (expense)					
Interest income, net	2,329	1,032	601	197	187
Other income (expense), net	(720)	(320)	732	(145)	(458)
Total other income (expense), net	1,609	712	1,333	52	(271)
Income before income taxes	28,340	10,693	7,718	7,075	4,112
Income tax expense	4,468	10,342	2,755	2,436	1,408
Net income	$23,872	$351	$4,963	$4,639	$2,704
Net income per share					
Basic	$1.39	$0.02	$0.29	$0.28	$0.17
Diluted	$1.36	$0.02	$0.29	$0.27	$0.16
Weighted average common shares outstanding					
Basic	17,196	17,183	16,947	16,565	16,236
Diluted	17,606	17,356	17,241	17,032	16,814

	As of December 31,				
	2018	2017	2016	2015	2014
	(In thousands)				
Balance Sheet Data					
Cash and cash equivalents	$133,859	$123,127	$115,877	$121,538	$130,795
Working capital	193,093	180,386	156,359	142,552	137,634
Total assets	386,123	339,738	300,080	261,731	243,775
Long-term liabilities	10,627	7,682	8,721	15,312	14,124
Total stockholders' equity	318,974	288,111	257,767	222,185	205,091

	Year Ended December 31,				
	2018	2017	2016	2015	2014
	(Unaudited, adjusted EBITDA in thousands)				

Operating Data					
Adjusted EBITDA [2]	$51,301	$34,170	$25,370	$22,620	$18,160
Non-GAAP income per diluted share with tax adjustments [3]	$2.05	$1.02	$0.68	$0.63	$0.48
Recurring revenue customers [4]	29,308	25,751	24,805	23,410	21,983

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[1] See stock-based compensation disclosures in Note L, expense was as follows (in thousands):

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	Year Ended December 31,				
	2018	2017	2016	2015	2014
Cost of revenues	$2,168	$1,887	$1,309	$989	$614
Sales and marketing	2,675	2,197	2,412	1,978	1,933
Research and development	1,505	949	618	640	444
General and administrative	6,162	7,694	3,684	2,772	2,405
Total	$12,510	$12,727	$8,023	$6,379	$5,396

(2) Adjusted EBITDA consists of net income adjusted for depreciation and amortization, interest expense, interest income, income tax expense, stock-based compensation expense, the discrete impact from tax law change and other adjustments as necessary for a fair presentation. In 2017, the discrete impact from tax law change included $6.8 million of tax expense related to The Tax Cuts and Jobs Act ("Tax Act") reduction in the corporate tax rate to 21.0% resulting in a decrease in our net deferred tax assets. Other adjustments included the impact of the fair value adjustment for the EDIAdmin earn-out liability in 2018, the fair value adjustment for the Toolbox Solutions share-based earn-out liability in 2016, a one-time Australian stamp duty tax related to the Leadtec acquisition in 2014, as well as the impact of use tax refunds in 2015, and 2014 related to items previously expensed. We use Adjusted EBITDA as a measure of operating performance because it assists us in comparing performance on a consistent basis, as it removes the impact of our capital structure from our operating results. We believe Adjusted EBITDA is useful to an investor in evaluating our operating performance because it is widely used to measure a company's operating performance without regard to items such as depreciation and amortization, which can vary depending upon accounting methods and the book value of assets, and to present a meaningful measure of corporate performance exclusive of our capital structure and the method by which assets were acquired. The following table provides a reconciliation of net income to Adjusted EBITDA (in thousands):

	Year Ended December 31,				
	2018	2017	2016	2015	2014
Net income	$23,872	$351	$4,963	$4,639	$2,704
Depreciation and amortization	12,686	11,782	11,336	9,572	8,570
Interest income, net	(2,329)	(1,032)	(601)	(197)	(187)
Income tax expense	4,468	3,544	2,755	2,436	1,408
Discrete impact from tax law change	—	6,798	—	—	—
Stock-based compensation expense	12,510	12,727	8,023	6,379	5,396
Other	94	—	(1,106)	(209)	269
Adjusted EBITDA	$51,301	$34,170	$25,370	$22,620	$18,160

(3) Non-GAAP income per share consists of net income plus stock-based compensation expense, amortization expense related to intangible assets, the discrete impact from tax law change and other adjustments as necessary for a fair presentation, divided by the weighted average number of shares of common stock outstanding during each period. Other adjustments included the impact of the fair value adjustment for the EDIAdmin earn-out liability in 2018 and the fair value adjustment for the Toolbox Solutions share-based earn-out liability in 2016.

Pursuant to a Compliance and Disclosure Interpretation published by the U.S. SEC in May 2016, related to the use of non-GAAP financial measures, in 2017, we began including an adjustment to non-GAAP income to reflect the income tax effects of the adjustments to GAAP net income (loss). To quantify the tax effects, we recalculate income tax expense excluding the direct book and tax effects of the specific items constituting the non-GAAP adjustments. The difference between this recalculated income tax expense and GAAP income tax expense is presented as the income tax effect of the non-GAAP adjustments.

We believe non-GAAP income per share is useful to an investor because it is widely used to measure a company's operating performance. The following table provides a reconciliation of net income to non-GAAP income per share (in thousands, except per share amounts):

	Year Ended December 31,				
	2018	2017	2016	2015	2014
Net income	$23,872	$351	$4,963	$4,639	$2,704
Stock-based compensation expense	12,510	12,727	8,023	6,379	5,396
Amortization of intangible assets	4,093	4,574	4,738	3,307	2,856
Discrete impact from tax law change	—	6,798	—	—	—
Other	94	—	(1,106)	—	—
Non-GAAP income as historically reported	N/A	N/A	$16,618	$14,325	$10,956
Income tax effects of adjustments	(4,468)	(6,775)	(4,870)	(3,566)	(2,891)
Non-GAAP income with tax adjustments	$36,101	$17,675	$11,748	$10,759	$8,065
Shares used to compute non-GAAP income per share					
Basic	17,196	17,183	16,947	16,565	16,236
Diluted	17,606	17,356	17,241	17,032	16,814
Non-GAAP income per share with tax adjustments					
Basic	$2.10	$1.03	$0.69	$0.65	$0.50
Diluted	$2.05	$1.02	$0.68	$0.63	$0.48
Non-GAAP income per share as historically reported					
Basic	N/A	N/A	$0.98	$0.86	$0.67
Diluted	N/A	N/A	$0.96	$0.84	$0.65

(4) This reflects the number of recurring revenue customers at the end of the period. Recurring revenue customers are customers with monthly to annual contracts to pay for recurring monthly services. A small portion of our recurring revenue customers consists of separate units within a larger organization. We treat each of these units, which may include divisions, departments, affiliates and franchises, as distinct customers. Our contracts with our recurring revenue customers typically allow the customer to cancel the contract for any reason with 30 to 90 days' notice.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations
The following discussion and analysis of our financial condition and results of operations should be read together with the section titled "Selected Financial Data" and our audited financial statements and related notes which are included elsewhere in this Annual Report on Form 10-K. Our actual results could differ materially from those anticipated in the forward-looking statements included in this discussion as a result of certain factors, including, but not limited to, those discussed in "Risk Factors" included elsewhere in this Annual Report on Form 10-K.

Overview

SPS Commerce is a leading provider of cloud-based solutions that make it easier for retailers, suppliers, grocers, distributors and logistics firms to orchestrate the management of item data, order fulfillment, inventory control and sales analytics across all channels. The solutions offered by SPS Commerce eliminate the need for on-premise software and support staff by taking on that capability on the customer's behalf. We derive the majority of our revenues from numerous monthly recurring subscriptions from businesses that utilize our solutions.

We plan to continue to grow our business by further penetrating the supply chain management market, increasing revenues from our customers as their businesses grow, expanding our distribution channels, expanding our international presence and, from time to time, developing new solutions and applications. We also intend to selectively pursue acquisitions that will add customers, allow us to expand into new regions or allow us to offer new functionalities.

For the years ended December 31, 2018, 2017 and 2016, we generated revenues of $248.2 million, $220.1 million and $193.2 million, respectively. Our fiscal quarter ended December 31, 2018 represented our 72nd consecutive quarter of increased revenues. Recurring revenues from recurring revenue customers accounted for 93%, 93% and 92% of our total revenues for the years ended December 31, 2018, 2017 and 2016, respectively. Our revenues are not concentrated with any customer, as our largest customer represented less than 1% of total revenues for the year ended December 31, 2018 and 2017 and less than 2% of total revenues for the year ended December 31, 2016.

Key Financial Terms and Metrics

Sources of Revenues

Trading Partner Community. Our Community solution provides communication programs based on our best practices. These programs enable organizations, from large and small retailers and suppliers to emerging providers of value-added products and services, to establish trading partner relationships with new trading partners to expand their businesses.

Trading Partner Fulfillment. Our Fulfillment solution provides fulfillment automation and replaces or augments an organization's existing trading partner electronic communication infrastructure, enabling suppliers to have visibility into the journey of an order and comply with retailers' rule books and enabling the electronic exchange of information among numerous trading partners through various protocols.

Trading Partner Assortment. Today's retail marketplace requires the management of numerous individual attributes associated with each item a retailer or supplier sells today. This information can include digital images/video, customer facing descriptions and measurements, and warehouse information. Our Assortment product provides robust, extensible management of this information, enabling accurate orders and rapid fulfillment.

Trading Partner Analytics. Our Analytics solution consists of data analytics applications that enable our customers to improve their visibility across, and analysis of, their supply chains. When focused on point-of-sale data, for example, retailers and suppliers can ensure inventory is located where demand is highest. Retailers improve their visibility into supplier performance and their understanding of product sell-through.

Trading Partner Sourcing. Through Retail Universe, our social network for the retail industry, retailers can source providers of new items, suppliers can connect with new retailers and the broader retailing community can make connections to expand their business networks and grow.

Other Trading Partner Solutions. We provide a number of peripheral solutions such as barcode labeling, planogram services and our scan and pack application, which helps trading partners process information to streamline the picking and packaging process.

Cost of Revenues and Operating Expenses

Cost of Revenues. Cost of revenues consist primarily of personnel costs for our customer success and implementation teams, customer support personnel and application support personnel. Cost of revenues also includes our cost of network services, which is primarily data center costs for the locations where we keep the equipment that serves our customers and connectivity costs that facilitate electronic data transmission between our customers and their trading partners.

Sales and Marketing Expenses. Sales and marketing expenses consist primarily of personnel costs for our sales, marketing and product management teams, commissions earned by our sales personnel and marketing costs.

Research and Development Expenses. Research and development expenses consist primarily of personnel costs for development of new and maintenance of existing solutions, net of amounts capitalized as developed software. Our research and development group is also responsible for enhancing existing solutions and applications, internal tools, and developing new information maps that integrate our customers to their trading partners in compliance with those trading partners' requirements.

General and Administrative Expenses. General and administrative expenses consist primarily of personnel costs for finance, human resources and internal information technology support, as well as legal, accounting and other fees, such as credit card processing fees.

Overhead Allocation. We allocate overhead expenses such as rent, certain employee benefit costs, office supplies and depreciation of general office assets to cost of revenues and operating expenses categories based on headcount.

Other Metrics

Recurring Revenue Customers. As of December 31, 2018, we had approximately 29,000 customers with contracts to pay us monthly fees, which we refer to as recurring revenue customers. We report recurring revenue customers as of the end of a period. A small portion of our recurring revenue customers consist of separate units within a larger organization. We treat each of these units, which may include divisions, departments, affiliates and franchises, as distinct customers.

Average Recurring Revenues Per Recurring Revenue Customer. We calculate average recurring revenues per recurring revenue customer, which we also refer to as wallet share, by dividing the recurring revenues from recurring revenue customers for the period by the average of the beginning and ending number of recurring revenue customers for the period. For interim periods, we annualize this number by multiplying the quotient calculated above by the quotient of 12 divided by the number of months in the period. We anticipate that average recurring revenues per recurring revenue customer will continue to increase as we increase the number of solutions we offer and increase the penetration of those solutions across our customer base.

Non-GAAP Financial Measures. To supplement our financial statements, we also provide investors with Adjusted EBITDA and non-GAAP income per share, both of which are non-GAAP financial measures. We believe that these non-GAAP measures provide useful information to management and investors regarding certain financial and business trends relating to our financial condition and results of operations. Our management uses these non-GAAP measures to compare the company's performance to that of prior periods for trend analyses and planning purposes. Adjusted EBITDA is also used for purposes of determining executive and senior management incentive compensation. These measures are also presented to our board of directors.

These non-GAAP measures should not be considered a substitute for, or superior to, financial measures calculated in accordance with GAAP. These non-GAAP financial measures exclude significant expenses and income that are required by GAAP to be recorded in the company's financial statements and are subject to inherent limitations. Investors should review the reconciliations of non-GAAP financial measures to the comparable GAAP financial measures that are included in this "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Critical Accounting Policies and Estimates

The discussion of our financial condition and results of operations is based upon our financial statements, which are prepared in accordance with GAAP. The preparation of these financial statements requires us to make estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, revenues, costs and expenses and related disclosures. On an ongoing basis, we evaluate our estimates and assumptions. We base our estimates of the carrying value of certain assets and liabilities on historical experience and on various other assumptions that we believe to be reasonable. Our actual results may differ from these estimates under different assumptions or conditions.

We believe that our significant accounting policies, which are described in the notes to our financial statements, involve a greater degree of judgment and complexity and are material to our financial statement presentation. A critical accounting policy is one that is both material to the presentation of our financial statements and requires us to make difficult, subjective or complex judgments for uncertain matters that could have a material effect on our financial condition and results of operations. Accordingly, these are the policies we believe are the most critical to aid in fully understanding and evaluating our financial condition and results of operations.

Revenue Recognition

Revenues are recognized when our services are made available to our customers, in an amount that reflects the consideration we are contractually and legally entitled to in exchange for those services. Our set-up fees from customers are one-time revenues that are specific for each connection a customer has with a trading partner and many of our customers have connections with numerous trading partners. Set-up fees related to our cloud-based supply chain management solutions are nonrefundable upfront fees that are necessary for our customers to utilize our cloud-based services. These set-up fees do not provide any standalone value to our customers.

Except for our Analytics solution, we have determined that the set-up fees represent a material renewal option right to our customers as they will not be incurred again upon renewal. These set-up fees and related costs are deferred and recognized ratably over two years, which is the estimated period for which a material right is present for our customers.

For our Analytics solution, we have determined that the set-up fees do not represent a material customer renewal right and, as such, are deferred and recognized ratably over the estimated initial contract term, which is one year.

Business Combinations

We allocate the fair value of purchase consideration to the tangible assets acquired, liabilities assumed, and intangible assets acquired based on their estimated fair values. The excess of the fair value of purchase consideration over the fair values of these identifiable assets and liabilities is recorded as goodwill. Such valuations require management to make significant estimates and assumptions, especially with respect to intangible assets.

Significant estimates in valuing certain intangible assets include, but are not limited to, future expected cash flows from acquired users, acquired technology, and trade names from a market participant perspective, useful lives, and discount rates. Significant estimates in valuing liabilities for contingent consideration include, but are not limited to, discount rates, projected financial results of the acquired businesses based on our most recent internal forecasts, and factors indicating the probability of achieving the forecasted results.

Management's estimates of fair value are based upon assumptions believed to be reasonable, but which are inherently uncertain and unpredictable and, as a result, actual results may differ from estimates. During the measurement period, which is not to exceed one year from the acquisition date, we may record adjustments to the assets acquired and liabilities assumed, with the corresponding offset to goodwill. Upon the conclusion of the measurement period, any subsequent adjustments are recorded to earnings.

Results of Operations

Year Ended December 31, 2018 Compared to Year Ended December 31, 2017

The following table presents our results of operations for the periods indicated (dollars in thousands):

	Year Ended December 31,				Change	
	2018		2017			
		% of revenue		% of revenue		%
Revenues	$248,240	100.0 %	$220,085	100.0 %	$28,155	12.8 %
Cost of revenues	81,748	32.9	73,625	33.5	8,123	11.0
Gross profit	166,492	67.1	146,460	66.5	20,032	13.7
Operating expenses						
Sales and marketing	71,719	28.9	71,261	32.4	458	0.6
Research and development	22,087	8.9	23,183	10.5	(1,096)	(4.7)
General and administrative	41,862	16.9	37,461	17.0	4,401	11.7
Amortization of intangible assets	4,093	1.6	4,574	2.1	(481)	(10.5)
Total operating expenses	139,761	56.3	136,479	62.0	3,282	2.4
Income from operations	26,731	10.8	9,981	4.5	16,750	167.8
Other income (expense)						
Interest income, net	2,329	0.9	1,032	0.5	1,297	125.7
Other expense, net	(720)	(0.3)	(320)	(0.1)	(400)	(125.0)
Total other income, net	1,609	0.6	712	0.3	897	126.0
Income before income taxes	28,340	11.4	10,693	4.9	17,647	165.0
Income tax expense	4,468	1.8	10,342	4.7	(5,874)	(56.8)
Net income	$23,872	9.6 %	$351	0.2 %	$23,521	6,701.1 %

Revenues. The increase in revenues resulted from two primary factors: the increase in recurring revenue customers, which is driven by continued business growth and by business acquisitions, and the increase in average recurring revenues per recurring revenue customer, which we also refer to as wallet share.

- The number of recurring revenue customers increased 14% to 29,308 at December 31, 2018 from 25,751 at December 31, 2017.
- Wallet share increased 4% to $8,378 at December 31, 2018 from $8,067 at December 31, 2017. This was primarily attributable to increased usage of our solutions by our recurring revenue customers.

Recurring revenues from recurring revenue customers increased 13% in 2018, as compared to 2017 and accounted for 93% of our total revenues for 2018 and 2017. We anticipate that the number of recurring revenue customers and wallet share will continue to increase as we increase the number of solutions we offer and increase the penetration of those solutions across our customer base.

Cost of Revenues. The increase in cost of revenues was primarily due to a $6.6 million increase in personnel-related costs, driven by increased salaries and benefits due to business growth and by increased contract labor. Additionally, computer depreciation expense increased $1.4 million due to continued investment in the infrastructure supporting our platform.

Sales and Marketing Expenses. The slight increase in sales and marketing was primarily due to an increase of $2.0 million from commissions offset by a net $1.8 million decrease in personnel-related costs and stock-based compensation. The increase in commissions was a result of new business and increased referral partnerships. The decrease in personnel-related costs was driven by decreased headcount which was partially offset by increased salaries, benefits, and stock-based compensation expense.

Research and Development Expenses. The decrease in research and development expenses was primarily due to a $4.3 million decrease in personnel-related costs related to an increase in internally developed capitalized software, driven by our continued investment in our technology. The decrease was offset by a $3.0 million increase from other personnel-related expenses, driven by continued business growth which led to increased headcount and increases to expenses for consulting, salaries, benefits, and stock-based compensation.

General and Administrative Expenses. The increase in general and administrative expenses was primarily due to continued business growth which drove a $2.8 million increase in personnel-related costs (headcount, salaries and benefits) and a $2.2 million increase in software subscriptions, credit card fees, and bad debt expense. Additionally, charitable contributions increased $0.5 million and acquisition-related costs increased $0.3 million, due to the acquisitions of EDIAdmin and CovalentWorks. These increases were offset by a $1.5 million decrease in stock-based compensation expenses, which normalized compared to the prior year increase which was driven by a modification to our Chief Executive Officer's employment agreement resulting in immediate vesting, and expensing, of his outstanding stock-based compensation awards based on his retirement eligibility.

Amortization of Intangible Assets. The decrease in amortization of intangible assets was driven by certain intangible assets being fully amortized in 2018, reducing the amortization expense in the current year, and was offset by a slight increase due to amortization of acquired intangible assets.

Other Income, net. The increase in other income was primarily due to a $1.0 million increase in investment income, driven by an increase in the average amount invested throughout 2018 compared to 2017, offset by a $0.1 million decrease in income, net, due to the fair value earn-out adjustment in 2018 related to the EDIAdmin acquisition.

Income Tax Expense. Our provisions for income taxes for 2018 and 2017 were $4.5 million and $10.3 million, respectively. The decrease in income tax expense was primarily due to a reduction in the corporate tax rate enacted in the Tax Act, and an increase in our federal research and development credit, partially offset by the increase in pre-tax net income. Further, the 2017 provision included a one-time discrete tax expense of $6.8 million from the Tax Act. Finally, the discrete tax benefit from stock-based compensation was $2.5 million in 2018 as compared to $0.9 million in 2017. See Note M to our consolidated financial statements, included in this Annual Report on Form 10-K, for additional information regarding our income taxes.

Adjusted EBITDA. Adjusted EBITDA, which is a non-GAAP measure of financial performance, consists of net income adjusted for depreciation and amortization, interest expense, interest income, income tax expense, stock-based compensation expense, the discrete impact from tax law change and other adjustments as necessary for a fair presentation. Other adjustments included the impact of an earn-out adjustment related to the EDIAdmin acquisition in 2018. The following table provides a reconciliation of net income to Adjusted EBITDA (in thousands):

	Year Ended December 31,	
	2018	2017
Net income	$23,872	$351
Depreciation and amortization	12,686	11,782
Interest income, net	(2,329)	(1,032)
Income tax expense	4,468	3,544
Discrete impact from tax law change	—	6,798
Stock-based compensation expense	12,510	12,727
Other	94	—
Adjusted EBITDA	$51,301	$34,170

Non-GAAP Income per Share. Non-GAAP income per share, which is also a non-GAAP measure of financial performance, consists of net income plus stock-based compensation expense, amortization expense related to intangible assets, the discrete impact from tax law change and other adjustments as necessary for a fair presentation, divided by the weighted average number of shares of common stock outstanding during each period. Other adjustments included the impact of the fair value adjustment for the EDIAdmin share-based earn-out liability in 2018.

Pursuant to a Compliance and Disclosure Interpretation published by the U.S. Securities and Exchange Commission in May 2016, related to the use of non-GAAP financial measures, in 2017, we began including an adjustment to non-GAAP income to reflect the income tax effects of the adjustments to GAAP net income. To quantify the tax effects, we recalculated income tax expense excluding the direct book and tax effects of the specific items constituting the non-GAAP adjustments. The difference between this recalculated income tax expense and GAAP income tax expense is presented as the income tax effect of the non-GAAP adjustments.

The following table provides a reconciliation of net income to non-GAAP income per share (in thousands, except per share amounts):

	Year Ended December 31, 2018	2017
Net income	$23,872	$351
Stock-based compensation expense	12,510	12,727
Amortization of intangible assets	4,093	4,574
Discrete impact from tax law change	—	6,798
Other	94	—
Income tax effects of adjustments	(4,468)	(6,775)
Non-GAAP income	$36,101	$17,675
Shares used to compute non-GAAP income per share		
Basic	17,196	17,183
Diluted	17,606	17,356
Non-GAAP income per share		
Basic	$2.10	$1.03
Diluted	$2.05	$1.02

Year Ended December 31, 2017 Compared to Year Ended December 31, 2016

The following table presents our results of operations for the periods indicated (dollars in thousands):

	Year Ended December 31, 2017		2016		Change	
		% of revenue		% of revenue		%
Revenues	$220,085	100.0 %	$193,153	100.0 %	$26,932	13.9 %
Cost of revenues	73,625	33.5	64,346	33.3	9,279	14 %
Gross profit	146,460	66.5	128,807	66.7	17,653	14 %
Operating expenses						
Sales and marketing	71,261	32.4	66,876	34.6	4,385	7 %
Research and development	23,183	10.5	21,981	11.4	1,202	5 %
General and administrative	37,461	17.0	28,827	14.9	8,634	30 %
Amortization of intangible assets	4,574	2.1	4,738	2.5	(164)	-3 %
Total operating expenses	136,479	62.0	122,422	63.4	14,057	11 %
Income from operations	9,981	4.5	6,385	3.3	3,596	56 %
Other income (expense)						
Interest income, net	1,032	0.5	601	0.3	431	72 %
Other income (expense)	(320)	(0.1)	732	0.4	(1,052)	-144 %
Total other income, net	712	0.3	1,333	0.7	(621)	-47 %
Income before income taxes	10,693	4.9	7,718	4.0	2,975	39 %
Income tax expense	10,342	4.7	2,755	1.4	7,587	275 %
Net income	$351	0.2 %	$4,963	2.6 %	$(4,612)	(92.9)%

Revenues. The increase in revenues resulted from two primary factors: the increase in recurring revenue customers and the increase in average recurring revenues per recurring revenue customer, which we also refer to as wallet share.

- The number of recurring revenue customers increased 4% to 25,751 at December 31, 2017 from 24,805 at December 31, 2016.
- Wallet share increased 10% to $8,067 for 2017 from $7,344 for 2016. This increase in wallet share was primarily attributable to increased fees resulting from increased usage of our solutions by our recurring revenue customers.

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Recurring revenues from recurring revenue customers increased 15% in 2017, as compared to 2016, and accounted for 93% of our total revenues for 2017 and 92% for 2016.

Cost of Revenues. The increase in cost of revenue was primarily due to increased personnel-related costs of approximately $7.3 million, driven by increased headcount. Compared to 2016, stock-based compensation expense increased $0.6 million and direct network costs decreased $0.2 million. We also incurred higher expense for software and cloud-based subscriptions of $0.9 million and depreciation expense of $0.7 million for continued investment in the infrastructure supporting our solutions.

Sales and Marketing Expenses. The increase in sales and marketing expense was primarily due to increased headcount in 2017, which resulted in higher personnel-related costs of $3.0 million and increased commissions of approximately $1.4 million earned by sales personnel and referral partners from generating new business. We also incurred $0.4 million in increased promotional expenses, $0.2 million in software and cloud-based subscriptions, offset by lower expense of $0.3 for depreciation and $0.2 million in stock-based compensation expense as compared to 2016.

Research and Development Expenses. The increase in research and development expenses was primarily due to higher expenses for software and cloud-based subscriptions of $0.7 million, higher personnel-related costs of $0.2 million and higher stock-based compensation of $0.3 million in 2017 compared to 2016.

General and Administrative Expenses. The increase in general and administrative expenses was primarily due to a $4.0 million increase in stock-based compensation driven by the immediate expensing of $3.6 million of equity awards due to a modification to our Chief Executive Officer’s employment agreement in 2017 which resulted in immediate vesting, and expensing, of his outstanding stock-based compensation awards based on his retirement eligibility. Increased headcount in 2017 resulted in higher personnel-related costs of $3.3 million. These increases were offset by lower charitable contributions, hardware not capitalized, and hardware maintenance costs in 2017 as compared to 2016.

Amortization of Intangible Assets. The decrease in amortization of intangible assets was due to certain intangible assets becoming fully amortized during 2017.

Other Income (Expense), net. Other income (expense), net for 2016 included a $1.0 million adjustment to the fair value of the Toolbox Solutions share-based earn-out liability due to a change in our estimate of probability of attainment. There was no similar charge during 2017 as the contingent consideration arrangement had been resolved.

Income Tax Expense. Our provisions for income taxes for 2017 and 2016 were $10.3 million and $2.8 million, respectively. The provision in 2017 included $6.8 million in income tax expense primarily driven by the reduction in the corporate income tax rate to 21% offset by $0.9 million of discrete tax benefits from the adoption of ASU 2016-09 relating to stock-based compensation. See Note M to our consolidated financial statements, included in this Annual Report on Form 10-K, for additional information regarding our income taxes.

Adjusted EBITDA. Adjusted EBITDA, which is a non-GAAP measure of financial performance, consists of net income plus depreciation and amortization, interest expense, interest income, income tax expense, stock-based compensation expense and other adjustments as necessary for a fair presentation. Other adjustments included the impact of an earn-out adjustment related to the Toolbox acquisition in 2016. The following table provides a reconciliation of net income to Adjusted EBITDA (in thousands):

	Year Ended December 31,	
	2017	2016
Net income	$351	$4,963
Depreciation and amortization	11,782	11,336
Interest income, net	(1,032)	(601)
Income tax expense	10,342	2,755
Stock-based compensation expense	12,727	8,023
Other	—	(1,106)
Adjusted EBITDA	$34,170	$25,370

Non-GAAP Income per Share. Non-GAAP income per share, which is also a non-GAAP measure of financial performance, consists of net income plus stock-based compensation expense and amortization expense related to intangible assets, the discrete impact from tax law change and other adjustments necessary for a fair presentation, divided by the weighted average number of shares of common stock outstanding during each period. Other adjustments included the impact of the fair value adjustment for the Toolbox Solutions share-based earn-out liability in 2016.

Pursuant to a Compliance and Disclosure Interpretation published by the U.S. Securities and Exchange Commission in May 2016, related to the use of non-GAAP financial measures, in 2017, we began including an adjustment to non-GAAP income to reflect the income tax effects of the adjustments to GAAP net income. To quantify the tax effects, we recalculated income tax expense excluding the direct book and tax effects of the specific items constituting the non-GAAP adjustments. The difference between this recalculated income tax expense and GAAP income tax expense is presented as the income tax effect of the non-GAAP adjustments.

The following table provides a reconciliation of net income to non-GAAP income per share (in thousands, except per share amounts):

	Year Ended December 31,	
	2017	2016
Net income	$351	$4,963
Stock-based compensation expense	12,727	8,023
Amortization of intangible assets	4,574	4,738
Discrete impact from tax law change	6,798	—
Other	—	(1,106)
Non-GAAP income as historically reported	N/A	$16,618
Income tax effects of adjustments	(6,775)	(4,870)
Non-GAAP income with tax adjustments	$17,675	$11,748
Shares used to compute non-GAAP income per share		
Basic	17,183	16,947
Diluted	17,356	17,241
Non-GAAP income per share with tax adjustments		
Basic	$1.03	$0.69
Diluted	$1.02	$0.68
Non-GAAP income per share as historically reported		
Basic	N/A	$0.98
Diluted	N/A	$0.96

Liquidity and Capital Resources

At December 31, 2018, our principal sources of liquidity were cash and cash equivalents, certificates of deposit and marketable securities totaling $178.4 million and accounts receivable, net of allowance for doubtful accounts, of $27.5 million compared to cash and cash equivalents and marketable securities totaling $168.5 million and accounts receivable, net of allowance for doubtful accounts, of $24.9 million at December 31, 2017. Certificates of deposit and marketable securities are invested in accordance with our investment policy, with a goal of maintaining liquidity and capital preservation. Our cash equivalents and marketable securities are held in highly liquid money market funds, commercial paper, federal agency securities and corporate debt securities.

Net Cash Flows from Operating Activities

Cash flows from operating activities was $55.0 million in 2018, compared to $31.1 million in 2017, an increase of $23.9 million. This is primarily driven by a $23.5 million increase in net income, with the remaining net increase of $0.4 million relating to increases due to continued business growth offset by a decrease to deferred income taxes.

Net cash provided by operating activities was $31.1 million for 2017 compared to $18.8 million for 2016. The increase in operating cash flows as compared to 2016 was driven by a $19.1 million increase in non-cash expenses and a $1.3 million increase in changes in assets and liabilities, primarily due to increases in deferred revenues, accrued expenses and accounts payable, partially offset by increases in deferred costs and deferred rent.

Cash Flows from Investing Activities

Net cash used in investing activities was $40.5 million for 2018 compared to $22.6 million for 2017. The increase was primarily due to $27.3 million used for acquisitions of business and intangible assets, driven by the acquisitions of EDIAdmin and CovalentWorks. Additionally, capital expenditures increased by $6.4 million, due to our business growth and continued investment in our technology. These increases were offset by a $15.3 million decrease in cash used compared to 2017, driven by minimal change in investments in 2018 compared to significant increases in investments in 2017.

Net cash used in investing activities was $22.6 million for 2017 compared to $34.1 million for 2016. The decrease in cash used was due to the 2016 acquisition of Toolbox Solutions for $18.0 million, partially offset by a $6.8 million increase in cash used for investments in 2017.

Net Cash Flows from Financing Activities

Net cash used in financing activities for 2018 was $3.8 million compared to $2.5 million in 2017, a $1.3 million increase. This increase is due to a $14 million increase in cash used for repurchases of common stock and offset by a $12.9 million increase in cash provided by proceeds from the exercise of options to purchase common stock, driven by the significant increase in the company’s stock price which increased option exercises.

Net cash provided by financing activities was $2.5 million for 2017, which consisted of $5.8 million of repurchases of our common stock, partially offset by $1.4 million and $1.9 million of proceeds from the exercise of stock options and the net proceeds from our employee stock purchase plan.

Effect of Foreign Currency Exchange Rate Changes

Our results of operations and cash flows were not materially affected by fluctuation in foreign currency exchange rates. We maintained approximately 6% of our total cash and cash equivalents outside of the U.S. in foreign currencies, primarily in Australian and Canadian dollars. We believe that a significant change in foreign currency exchange rates or an inability to access these funds would not affect our ability to meet our operational needs.

Adequacy of Capital Resources

Our future capital requirements may vary significantly from those now planned and will depend on many factors, including:

- costs to develop and implement new solutions and applications, if any;
- sales and marketing resources needed to further penetrate our market and gain acceptance of new solutions and applications that we may develop;
- expansion of our operations in the U.S. and internationally;
- response of competitors to our solutions and applications; and
- use of capital for acquisitions, if any.

Historically, we have experienced increases in our expenditures consistent with the growth in our operations and personnel, and we anticipate that our expenditures will continue to increase as we expand our business.

We believe our cash, cash equivalents, marketable securities and cash flows from our operations will be sufficient to meet our working capital and capital expenditure requirements for at least the next twelve months.

During the last three years, inflation and changing prices have not had a material effect on our business and we do not expect that inflation or changing prices will materially affect our business in the foreseeable future.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements, investments in special purpose entities or undisclosed borrowings or debt. Additionally, we are not a party to any derivative contracts or synthetic leases.

Contractual and Commercial Commitment Summary

Our contractual obligations and commercial commitments as of December 31, 2018 are summarized below:

	Payments Due By Period (in thousands)				
Contractual Obligations	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
Operating lease obligations	$24,878	$4,209	$7,956	$7,896	$4,817

Recently Adopted Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606) and Other Assets and Deferred Costs – Contracts with Customers (Subtopic 340-40), which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This guidance replaced most existing revenue recognition guidance in GAAP. Topic 606 also includes Subtopic 340-40, Other Assets and Deferred Costs – Contracts with Customers, which requires the deferral of incremental costs of obtaining a contract with a customer. Collectively, we refer to Topic 606 and Subtopic 340-40 as the "new standard". These requirements are effective for annual reporting periods beginning after December 15, 2017, and interim periods within those annual periods.

We adopted the new standard effective January 1, 2018, on a retrospective basis. The new standard did not impact our recognition of the recurring revenue received from customers for our cloud-based supply chain solutions; however, the adoption of the new standard impacted our accounting for certain upfront set-up fees, the periods over which the related revenues are recognized and the timing of revenue recognition for these set-up fees. The adoption of the new standard also impacted our accounting for certain costs to obtain our contracts, specifically related to the periods over which commissions are recognized. Additional information regarding the adoption of this standard is contained in Note A and Note C.

In January 2018, we adopted FASB ASU 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business, which clarifies the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as business acquisitions or as an asset acquisition. The new standard specifies the required inputs and processes that are necessary to be a business. The adoption of this standard impacted our accounting for business combinations. See Note B for additional information regarding business combinations.

In March 2018, we adopted FASB ASU 2018-05, Income Taxes (Topic 740): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118, which updates the income tax accounting in U.S. GAAP to reflect the SEC interpretive guidance released on December 22, 2017, when the Tax Act was signed into law. Additional information regarding the adoption of this standard is contained in Note M.

In October 2018, we early adopted FASB ASU 2018-15, Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract, which aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. The standard is effective for interim and annual reporting periods beginning after December 15, 2019 and can be applied either prospectively to implementation costs incurred after the date of adoption or retrospectively to all arrangements, with early adoption permitted. Additional information regarding the adoption of this standard is contained in Note I.

Accounting Pronouncements Not Yet Adopted

In February 2016, the FASB issued ASU 2016-02, Leases, which will supersede existing lease guidance and will require all leases with a term greater than 12 months to be recognized in the statements of financial position and eliminate current real estate-specific lease guidance, while maintaining substantially similar classification criteria for distinguishing between finance leases and operating leases. This standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018, with early adoption permitted.

We adopted the new standard on January 1, 2019 and used the effective date as our date of initial application. Consequently, financial information will not be updated and the disclosures required under the new standard will not be provided for dates and periods before January 1, 2019.

The new standard provides several optional practical expedients in transition. For the fiscal period beginning January 1, 2019, we have made the following elections. We elected the "package of practical expedients," which permits us not to reassess under the new standard our prior conclusions about lease identification, lease classification and initial direct costs. We did not elect the use-of hindsight or the practical expedient pertaining to land easements; the latter not being applicable to us. The new standard also provided practical expedients for an entity's ongoing accounting. We elected the short-term lease recognition exemption for all leases that qualify, which means we have not recognized right-of-use ("ROU") assets or lease liabilities for these leases, and this included not recognizing ROU assets or lease liabilities for existing short-term leases of those assets in transition. We also elected the practical expedient to not separate lease and non-lease components for all leases.

This standard has a material effect on our financial statements beginning January 1, 2019. The most significant effects relate to the recognition of approximately $15.0 million in ROU assets and $15.0 million additional lease liabilities on our balance sheet for our existing operating leases.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments. The amendment in this update replaces the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses on instruments within its scope, including trade receivables. This update is intended to provide financial statement users with more decision-useful information about the expected credit losses. This ASU is effective for annual periods and interim periods for those annual periods beginning after December 15, 2019. Entities may early adopt beginning after December 15, 2018. We are currently evaluating the impact of the adoption of ASU 2016-13 on our consolidated financial statements.

In February 2018, the FASB issued ASU 2018-02, Income Statement – Reporting Comprehensive Income (Topic 220), which allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Act and requires certain disclosures regarding stranded tax effects in accumulated other comprehensive income. This guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018, with early adoption permitted during interim or annual periods. We believe the adoption of this standard will not have a material impact on our consolidated financial statements.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Sensitivity Risk. The principal objectives of our investment activities are to preserve principal, provide liquidity and maximize income consistent with minimizing risk of material loss. We are exposed to market risk related to changes in interest rates. However, based on the nature and current level of our investments (primarily cash and cash equivalents, which approximate fair value due to their short maturities, certificates of deposit and marketable securities), we believe there is no material risk exposure. We do not enter into investments for trading or speculative purposes.

We did not have any outstanding debt as of December 31, 2018 and 2017. We therefore do not have any material risk to interest rate fluctuations.

Foreign Currency Exchange Risk. We have revenue, expenses, assets and liabilities that are denominated in currencies other than the U.S. dollar, primarily the Australian dollar and Canadian dollar. As of December 31, 2018, we maintained approximately 6% of our total cash and cash equivalents outside of the U.S. in foreign currencies, primarily in Australian and Canadian dollars. We believe that a significant change in foreign currency exchange rates or an inability to access these funds would not affect our ability to meet our operational needs. As we expand internationally, our results of operations and cash flows may be impacted by changes in foreign currency exchange rates, and would be adversely impacted when the U.S. dollar appreciates relative to other foreign currencies. We have not used any forward contracts or currency borrowings to hedge our exposure to foreign currency exchange risk, although we may do so in the future.

Item 8. Financial Statements and Supplementary Data

SPS Commerce, Inc. and Subsidiaries Consolidated Financial Statements

Report of Independent Registered Public Accounting Firm

To the Stockholders and Board of Directors
SPS Commerce, Inc.:

Opinions on the Consolidated Financial Statements and Internal Control Over Financial Reporting

We have audited the accompanying consolidated balance sheets of SPS Commerce, Inc. and subsidiaries (the Company) as of December 31, 2018 and 2017, the related consolidated statements of comprehensive income, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2018, and the related notes (collectively, the consolidated financial statements). We also have audited the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2018, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Change in Accounting Principle

As discussed in Note A to the financial statements, the Company has changed its method of accounting for revenue on January 1, 2018 due to the full retrospective adoption of FASB Accounting Standards Update No. 2014-09 (Topic 606), Revenue from Contracts with Customers.

Basis for Opinions

The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's consolidated financial statements and an opinion on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

SPS Commerce, Inc. acquired the net assets of EDIAdmin and the net assets of CovalentWorks during the fourth quarter of 2018, and management excluded from its assessment of the effectiveness of internal control over financial reporting as of December 31, 2018, EDIAdmin's and CovalentWorks' internal control over financial reporting associated with approximately two and six percent of total assets, respectively, and each represents less than one percent of total revenues, in the consolidated financial statements of SPS Commerce, Inc. as of and for the year ended December 31, 2018. Our audit of internal control over financial reporting of SPS Commerce, Inc. also excluded an evaluation of the internal control over financial reporting of EDIAdmin and CovalentWorks.

/s/ KPMG LLP

We have served as the Company's auditor since 2013.

Minneapolis, Minnesota
February 22, 2019

SPS COMMERCE, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(In thousands, except shares)

	December 31, 2018	2017
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$133,859	$123,127
Short-term investments	44,537	40,192
Accounts receivable, net	27,488	24,897
Deferred costs	34,502	29,966
Other current assets	9,229	6,149
Total current assets	249,615	224,331
PROPERTY AND EQUIPMENT, net	20,957	16,856
GOODWILL	69,658	51,613
INTANGIBLE ASSETS, net	22,741	16,529
INVESTMENTS	—	5,206
OTHER ASSETS		
Deferred costs	10,973	9,967
Deferred income tax asset	10,456	13,697
Other assets	1,723	1,539
Total assets	$386,123	$339,738
LIABILITIES AND STOCKHOLDERS’ EQUITY		
CURRENT LIABILITIES		
Accounts payable	$4,440	$4,463
Accrued compensation	20,415	15,228
Accrued expenses	4,558	4,712
Deferred revenue	25,328	17,863
Deferred rent	1,781	1,679
Total current liabilities	56,522	43,945
OTHER LIABILITIES		
Deferred revenue	2,512	2,731
Deferred rent	5,371	3,064
Deferred income tax liability	1,376	1,887
Other non-current liabilities	1,368	—
Total liabilities	67,149	51,627
COMMITMENTS and CONTINGENCIES		
STOCKHOLDERS’ EQUITY		
Preferred stock, $0.001 par value; 5,000,000 shares authorized; 0 shares issued and outstanding	—	—
Common stock, $0.001 par value; 55,000,000 shares authorized; 17,757,628 and 17,249,153 shares issued; and 17,345,736 and 17,127,006 outstanding, respectively	18	17
Treasury stock, at cost; 411,892 and 122,147 shares, respectively	(25,679)	(5,815)
Additional paid-in capital	332,592	301,863

Retained earnings (accumulated deficit)	15,261	(8,611)
Accumulated other comprehensive (loss) income	(3,218)	657
Total stockholders’ equity	318,974	288,111
Total liabilities and stockholders’ equity	$386,123	$339,738

See accompanying notes to these consolidated financial statements.

SPS COMMERCE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands, except per share amounts)

	Year Ended December 31,		
	2018	2017	2016
Revenues	$248,240	$220,085	$193,153
Cost of revenues	81,748	73,625	64,346
Gross profit	166,492	146,460	128,807
Operating expenses			
Sales and marketing	71,719	71,261	66,876
Research and development	22,087	23,183	21,981
General and administrative	41,862	37,461	28,827
Amortization of intangible assets	4,093	4,574	4,738
Total operating expenses	139,761	136,479	122,422
Income from operations	26,731	9,981	6,385
Other income (expense)			
Interest income, net	2,329	1,032	601
Other income (expense), net	(720)	(320)	732
Total other income, net	1,609	712	1,333
Income before income taxes	28,340	10,693	7,718
Income tax expense	4,468	10,342	2,755
Net income	$23,872	$351	$4,963
Net income per share			
Basic	$1.39	$0.02	$0.29
Diluted	$1.36	$0.02	$0.29
Weighted average common shares used to compute net income per share			
Basic	17,196	17,183	16,947
Diluted	17,606	17,356	17,241
Other comprehensive income			
Foreign currency translation adjustments	(3,999)	3,944	336
Unrealized gain (loss) on investments, net of tax of $132, $0 and ($5)	397	-	(9)
Reclassification of unrealized (gain) loss on investments into earnings, net of tax of ($91), $24 and $0	(273)	39	-
Comprehensive income	$19,997	$4,334	$5,290

See accompanying notes to these consolidated financial statements.

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SPS COMMERCE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(In thousands, except shares)

	Common Stock		Treasury Stock		Additional Paid-in	Retained Earnings (Accumulated	Accumulated Other Comprehensive Income	Total Stockholders'
	Shares	Amount	Shares	Amount	Capital	Deficit)	(Loss)	Equity
Balances, December 31, 2015	16,723,994	17	—	—	265,265	(30,202)	(3,648)	231,432
Stock-based compensation	—	—	—	—	8,023	—	—	8,023
Exercise of stock options and issuance of restricted stock	279,841	—	—	—	4,303	—	—	4,303
Excess tax benefit of stock options exercised	—	—	—	—	4,070	—	—	4,070
Employee stock purchase plan	33,357	—	—	—	1,732	—	—	1,732
Stock issued for acquisition	43,953	—	—	—	2,922	—	—	2,922
Net income	—	—	—	—	—	4,963	—	4,963
Foreign currency translation adjustments	—	—	—	—	—	—	336	336
Reclassification of loss on investments into earnings	—	—	—	—	—	—	18	18
Unrealized loss on investments	—	—	—	—	—	—	(32)	(32)
Balances, December 31, 2016	17,081,145	17	—	—	286,315	(25,239)	(3,326)	257,767
Stock-based compensation	—	—	—	—	12,728	—	—	12,728
Exercise of stock options and issuance of restricted stock	135,906	—	—	—	1,410	—	—	1,410
Cumulative-effect adjustment for previously unrecognized excess tax benefits	—	—	—	—	—	16,277	—	16,277
Employee stock purchase plan	40,968	—	—	—	1,933	—	—	1,933

Retirement of escrow shares	(8,866)	—	—	—	(523)	—	—	(523)
Repurchases of common stock	(122,147)	—	122,147	(5,815)	—	—	—	(5,815)
Net income	—	—	—	—	—	351	—	351
Foreign currency translation adjustments	—	—	—	—	—	—	3,944	3,944
Reclassification of loss on investments into earnings	—	—	—	—	—	—	39	39
Balances, December 31, 2017	17,127,006	17	122,147	(5,815)	301,863	(8,611)	657	288,111
Stock-based compensation	—	—	—	—	11,270	—	—	11,270
Exercise of stock options and issuance of restricted stock	433,199	1	—	—	14,343	—	—	14,344
Employee stock purchase plan	34,798	—	—	—	1,745	—	—	1,745
Repurchases of common stock	(289,745)	—	289,745	(19,864)	—	—	—	(19,864)
Stock issued for acquisition	40,478	—	—	—	3,371	—	—	3,371
Net income	—	—	—	—	—	23,872	—	23,872
Foreign currency translation adjustments	—	—	—	—	—	—	(3,999)	(3,999)
Reclassification of gain on investments into earnings	—	—	—	—	—	—	(273)	(273)
Unrealized gain on investments, net of tax	—	—	—	—	—	—	397	397
Balances, December 31, 2018	17,345,736	$ 18	411,892	$ (25,679)	$ 332,592	$ 15,261	$ (3,218)	$ 318,974

See accompanying notes to these consolidated financial statements.

SPS COMMERCE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Year Ended December 31,		
	2018	2017	2016
Cash flows from operating activities			
Net income	$23,872	$351	$4,963
Reconciliation of net income to net cash provided by operating activities			
Deferred income taxes	2,798	9,616	(2,083)
Earn-out liability	94	—	(1,103)
Depreciation and amortization of property and equipment	8,593	7,208	6,598
Amortization of intangible assets	4,093	4,574	4,738
Provision for doubtful accounts	2,592	1,705	1,375
Stock-based compensation	12,510	12,728	8,023
Other, net	(364)	(15)	—
Changes in assets and liabilities, net of effects of acquisition			
Accounts receivable	(4,569)	(5,586)	(3,735)
Deferred costs	(5,564)	(7,813)	(4,085)
Other current and non-current assets	(3,333)	393	(1,911)
Accounts payable	937	832	(382)
Accrued compensation	3,957	1,304	2,291
Accrued expenses	(135)	1,192	990
Deferred revenue	7,094	5,588	2,852
Deferred rent	2,440	(1,027)	234
Net cash provided by operating activities	55,015	31,050	18,765
Cash flows from investing activities			
Purchases of property and equipment	(13,750)	(7,271)	(8,008)
Purchases of investments	(81,666)	(47,878)	(23,135)
Maturities of investments	82,224	33,029	15,018
Acquisition of business and intangible assets, net of cash acquired	(27,273)	(500)	(18,032)
Net cash used in investing activities	(40,465)	(22,620)	(34,157)
Cash flows from financing activities			
Repurchases of common stock	(19,864)	(5,815)	—
Net proceeds from exercise of options to purchase common stock	14,344	1,410	4,303
Excess tax benefit from exercise of options to purchase common stock	—	—	4,070
Net proceeds from employee stock purchase plan	1,745	1,933	1,732

Net cash (used in) provided by financing activities	(3,775)	(2,472)	10,105
Effect of foreign currency exchange rate changes	(43)	1,292	(374)
Net increase (decrease) in cash and cash equivalents	10,732	7,250	(5,661)
Cash and cash equivalents at beginning of year	123,127	115,877	121,538
Cash and cash equivalents at end of year	$133,859	$123,127	$115,877
Supplemental disclosure of cash flow information			
Cash paid for income taxes, net	$1,534	$1,068	$722
Non-cash financing activities:			
Net purchases of property and equipment on account	$405	$1,335	$—
Common stock issued for business acquisitions	$3,371	$—	$2,922

See accompanying notes to these consolidated financial statements.

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SPS COMMERCE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE A – General

Business Description

SPS Commerce is a leading provider of cloud-based supply chain management solutions that make it easier for retailers, suppliers, distributors, and logistics firms to orchestrate the management of item data, order fulfillment, inventory control and sales analytics across all channels. Implementing and maintaining a suite of supply chain management capabilities is resource intensive and is not a core competency for most businesses. The solutions offered by SPS commerce eliminate the need for on-premise software and support staff by taking on that capability on the customer's behalf. The solutions SPS Commerce provides allow our customers to increase their supply cycle agility, optimize their inventory levels and sell-through, reduce operational costs and gain increased visibility into customer orders, ensuring that suppliers, distributors, and logistics firms can satisfy exacting retailer requirements.

Basis of Presentation

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP") and include the accounts of SPS Commerce, Inc. and its subsidiaries. All intercompany accounts and transactions have been eliminated in the consolidated financial statements.

Foreign Currency Translation

Assets and liabilities denominated in currencies other than the U.S. dollar are translated into U.S. dollars at the exchange rates in effect at the balance sheet date, with the resulting translation adjustments recorded as a separate component of accumulated other comprehensive loss. Income and expense accounts are translated at the average exchange rates during the year. Foreign currency transaction gains and losses, if any, are included in net income.

Use of Estimates

Preparing financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Business Combinations

We recognize the fair value of the assets acquired and the liabilities assumed at the acquisition date, separately from goodwill. Goodwill as of the acquisition date is measured as the excess of consideration transferred and the net of the acquisition date amounts of the assets acquired and the liabilities assumed.

Assets acquired include tangible and intangible assets. We use estimates and assumptions that we believe are reasonable as a part of the purchase price allocation, which includes the process to determine the value and useful lives of purchased intangible assets and the process to determine the value of any contingent consideration liabilities. We recorded the acquisition-date fair value of any contingent liabilities, such as earn-out provisions, as part of the consideration transferred. The earn-out liability fair value is subsequently remeasured at each reporting date. The Company evaluates each contingent consideration to determine the valuation approach. See Note B for valuation methods utilized in the fair value measurement as of the acquisition date and see Note E for valuation methods utilized in the fair value remeasurement as of the reporting date.

While we believe these estimates and assumptions are reasonable, they are inherently uncertain and subject to refinement. As a result, during the measurement period, which may be up to one year from the acquisition date, we may record adjustments to the fair value of the assets acquired and the liabilities assumed. Any such adjustments would be recorded as an offset to goodwill. Upon the conclusion of the measurement period or final determination of the fair values, whichever comes first, any subsequent adjustments would be recorded in our consolidated statements of comprehensive income.

Segment Information

We operate in and report on one segment, which is supply chain management solutions.

Risk and Uncertainties

We rely on hardware and software licensed from third parties to offer our on-demand solutions. Our management believes alternate sources are available; however, disruption or termination of these relationships could adversely affect our operating results in the near term.

Concentration of Credit Risk

Financial instruments that potentially subject us to concentrations of credit risk consist principally of cash and cash equivalents in financial institutions in excess of federally insured limits and trade accounts receivable. Cash investments are held with financial institutions that we believe are subject to minimal risk.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash and highly liquid investments with original maturities of less than 90 days. Cash and cash equivalents are stated at fair value.

Investments

Management determines the appropriate classification of certificates of deposit and marketable securities at the time of purchase and reevaluates such determination at each balance sheet date. Securities are classified as available for sale and are carried at fair value, with the change in unrealized gains and losses, net of tax, reported as a separate component on the consolidated statements of comprehensive income. Fair value is determined based on quoted market rates when observable or utilizing data points that are observable, such as quoted prices, interest rates and yield curves. When a determination has been made that an other-than-temporary decline in fair value has occurred, the amount of the decline that is related to a credit loss is realized and is included in other income (expense), net in the consolidated statements of comprehensive income.

Fair Value of Financial Instruments

The carrying amounts of our financial instruments, which include cash, cash equivalents, accounts receivable, accounts payable and other accrued expenses, approximates fair value due to their short maturities. Marketable securities are recorded at fair value as further described in Note E.

Accounts Receivable

Accounts receivable are initially recorded upon the sale of solutions to customers. Credit is granted in the normal course of business without collateral. Accounts receivable are stated net of allowances for doubtful accounts, which represent estimated losses resulting from the inability of certain customers to make the required payments. When determining the allowances for doubtful accounts, we take several factors into consideration including the overall composition of the accounts receivable aging, our prior history of accounts receivable write-offs, the type of customers and our experience with specific customers. We write-off accounts receivable when they are determined to be uncollectible. Changes in the allowances for doubtful accounts are recorded as bad debt expense and are included in general and administrative expense in our consolidated statements of comprehensive income.

Property and Equipment

Property and equipment, including assets acquired under capital lease obligations, are stated at cost, net of accumulated depreciation and amortization. Depreciation and amortization are computed using the straight-line method over the estimated useful lives when placed in service, which are:

Computer equipment and software: 2 to 3 years

Office equipment and furniture: 5 to 7 years

Leasehold improvements: the shorter of the useful life of the asset or the remaining term of the lease

Significant additions or improvements extending asset lives beyond one year are capitalized, while repairs and maintenance are charged to expense as incurred. We also capitalize and amortize eligible costs to acquire or develop external-use software that are incurred after technological feasibility has been established. The assets and related accumulated depreciation and amortization are adjusted for asset retirements and disposals with the resulting gain or loss included in our consolidated statements of comprehensive income.

Research and Development

Research and development costs primarily include maintenance and data conversion activities related to our cloud-based supply chain management solutions and are expensed as incurred.

Goodwill

Goodwill represents the excess of the purchase price over the fair value of identifiable net assets acquired in business combinations. We test goodwill for impairment annually at November 30, or more frequently if events or changes in circumstances indicate that the asset might be impaired. The impairment test is conducted by comparing the fair value of the net assets with the carrying value of the reporting unit. Fair value is determined using the direct market observation of market price and outstanding equity of the reporting unit at the testing date. If the carrying value of the goodwill exceeds the fair value of the reporting unit, goodwill may be impaired. If this occurs, the fair value is then allocated to its assets and liabilities in a manner similar to a purchase price allocation in order to determine the implied fair value of goodwill. This implied fair value is then compared to the carrying amount of goodwill and, if it is less, we would recognize an impairment loss.

Intangible Assets

Assets acquired in business combinations may include identifiable intangible assets such as subscriber relationships and non-competition agreements. We recognize separately from goodwill the fair value of the identifiable intangible assets acquired. We have determined the fair value and useful lives of our purchased intangible assets using certain estimates and assumptions that we believe are reasonable.

The purchased intangible assets are being amortized on a straight-line basis over their estimated useful lives, which are three to ten years for subscriber relationships, two to five years for non-competition agreements and one to ten years for technology and other.

Internal-use Software Implementation Assets

Internal-use software implementation costs are capitalized assets included in Other Assets and relate to costs incurred during the application development stage for various internal-use software from hosting arrangements.

Capitalized implementation costs are recognized on a straight-line basis beginning when the application is ready for its intended use and ending on the expected termination date of the hosting arrangement, including consideration of the noncancelable contractual term and reasonably certain renewals.

The terms are between four and five years for our current hosting arrangements. Recognized expense is reported in general and administrative expense, which is where the hosting arrangement subscriptions are reported.

Impairment of Long-Lived Assets

We review our long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The carrying amount of a long-lived asset is not recoverable if the carrying amount of an asset group exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the assets at the date it is tested for recoverability, whether in use or under development. An impairment loss is measured as the amount by which the carrying amount of a long-lived asset exceeds its fair value.

Revenue Recognition

Revenues are recognized when our services are made available to our customers, in an amount that reflects the consideration we are contractually and legally entitled to in exchange for those services.

We determine revenue recognition through the following steps:

- Identification of the contract, or contracts, with a customer
- Identification of the performance obligations in the contract
- Determination of the transaction price
- Allocation of the transaction price to the performance obligations in the contract
- Recognition of revenue when, or as, we satisfy a performance obligation

See Note C for further descriptions of our revenue recognition policy.

Deferred Costs

Deferred costs consist of costs to obtain customer contracts, such as commissions paid to sales personnel and to third-party partners for customer referrals, and costs to fulfill customer contracts, such as customer implementation costs.

Sales commissions relating to recurring revenues are considered incremental and recoverable costs of obtaining a contract with our customer. These commissions are calculated based on estimated annual recurring revenue to be generated over the customer’s initial contract year. These costs are deferred and amortized over the expected period of benefit which we have determined to be two years. Amortization expense is included in sales and marketing expenses in the accompanying condensed consolidated statements of comprehensive income.

Stock-Based Compensation

We recognize the cost of all share-based payments to employees, including grants of employee stock options, in the financial statements based on the grant date fair value of those awards. This cost is recognized over the period for which an employee is required to provide service in exchange for the award.

In valuing share-based awards, judgment is required in determining the expected volatility of common stock and the expected term individuals will hold their share-based awards prior to exercising. The expected volatility of the options is based on the historical volatility of our common stock. The expected term of the options is based on the simplified method which does not consider historical employee exercise behavior. The valuation does not include a forfeiture estimate as we recognize forfeitures as they occur.

Income Taxes

We account for income taxes using the asset and liability method, which requires recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. Deferred tax assets are reduced by a valuation allowance when, in our judgement, there is a less than a 50% likelihood that the deferred tax asset will be utilized.

We assess our ability to realize our deferred tax assets at the end of each reporting period. Realization of our deferred tax assets is contingent upon future taxable earnings. Accordingly, this assessment requires estimates and judgment. If the estimates of future taxable income vary from actual results, our assessment regarding the realization of these deferred tax assets could change. Future changes in the estimated amount of deferred taxes expected to be realized will be reflected in our consolidated financial statements in the period the estimate is changed, with a corresponding adjustment to our operating results.

We recognize the financial statement benefit of a tax position only after determining that the relevant tax authority would “more likely than not” sustain the position following an audit. For tax positions meeting the “more likely than not” threshold, the amount recognized in the financial statements is the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement with the relevant tax authority.

Net Income Per Share

Basic net income per share has been computed using the weighted average number of shares of common stock outstanding during each period. Diluted net income per share also includes the impact of our outstanding potential common shares, including options, restricted stock units and restricted stock awards. Potential common shares that are anti-dilutive are excluded from the calculation of diluted net income per share.

Recently Adopted Accounting Pronouncements

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606) and Other Assets and Deferred Costs – Contracts with Customers (Subtopic 340-40), which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This guidance replaced most existing revenue recognition guidance in GAAP. Topic 606 also includes Subtopic 340-40, Other Assets and Deferred Costs – Contracts with Customers, which requires the deferral of incremental costs of obtaining a contract with a customer. Collectively, we refer to Topic 606 and Subtopic 340-40 as the “new standard”. These requirements are effective for annual reporting periods beginning after December 15, 2017, and interim periods within those annual periods.

We adopted the new standard effective January 1, 2018, on a retrospective basis. The new standard did not impact our recognition of the recurring revenue received from customers for our cloud-based supply chain solutions; however, the adoption of the new standard impacted our accounting for certain upfront set-up fees, the periods over which the related revenues are recognized and the timing of revenue recognition for these set-up fees. The adoption of the new standard also impacted our accounting for certain costs to obtain our contracts, specifically related to the periods over which commissions are recognized.

Selected audited consolidated balance sheet line items, which reflect the adoption of ASU 2014-09 are as follows (in thousands):

	December 31, 2017		
	As previously reported	Adjustments	As adjusted
ASSETS			
Deferred costs	$25,091	$ 4,875	$29,966
Deferred costs, non-current	6,770	3,197	9,967
Deferred income tax asset	17,551	(3,854)	13,697
LIABILITIES			
Accrued compensation	15,886	(658)	15,228
Deferred revenue	16,407	1,456	17,863
Deferred revenue, non-current	10,602	(7,871)	2,731
STOCKHOLDERS' EQUITY			
Accumulated deficit	(19,902)	11,291	(8,611)

Selected audited consolidated statement of operations line items, which reflect the adoption of ASU 2014-09 are as follows (in thousands):

	For the twelve months ended December 31, 2016		
	As previously reported	Adjustments	As adjusted
Revenues	$193,295	$ (142)	$193,153
Operating expenses			
Sales and marketing	65,886	990	66,876
Income from operations	7,517	(1,132)	6,385
Income tax expense	3,140	(385)	2,755
Net income	$5,710	$ (747)	$4,963
Net income per share			
Basic	$0.34	(0.05)	$0.29
Diluted	$0.33	(0.04)	$0.29

	For the twelve months ended December 31, 2017	
	As previously reported	Adjustments

			As adjusted
Revenues	$220,566	$ (481)	$220,085
Operating expenses			
Sales and marketing	73,295	(2,034)	71,261
Income from operations	8,428	1,553	9,981
Income tax expense	11,580	(1,238)	10,342
Net income (loss)	$(2,440)	$ 2,791	$351
Net income (loss) per share			
Basic	$(0.14)	0.16	$0.02
Diluted	$(0.14)	0.16	$0.02

Selected audited consolidated statement of cash flows line items, which reflect the adoption of ASU 2014-09 are as follows (in thousands):

	For the twelve months ended December 31, 2016		
	As previously reported	Adjustments	As adjusted
Cash flows from operating activities			
Net income	$5,710	$ (747)	$4,963
Reconciliation of net income to net cash provided by operating activities			
Deferred income taxes	(1,698)	(385)	(2,083)
Changes in assets and liabilities			
Deferred costs	(4,964)	879	(4,085)
Accrued compensation	2,180	111	2,291
Deferred revenue	2,710	142	2,852
Net cash provided by operating activities	18,765	—	18,765

	For the twelve months ended December 31, 2017		
	As previously reported	Adjustments	As adjusted
Cash flows from operating activities			
Net income (loss)	$(2,440)	$ 2,791	$351
Reconciliation of net income to net cash provided by operating activities			
Deferred income taxes	10,854	(1,238)	9,616
Changes in assets and liabilities			
Deferred costs	(6,548)	(1,265)	(7,813)
Accrued compensation	2,073	(769)	1,304
Deferred revenue	5,107	481	5,588
Net cash provided by operating activities	31,050	—	31,050

In January 2018, we adopted FASB ASU 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business, which clarifies the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as business acquisitions or as an asset acquisition. The new standard specifies the required inputs and processes that are necessary to be a business. The adoption of this standard impacted our accounting for business combinations. See Note B for additional information regarding business combinations.

In March 2018, we adopted FASB ASU 2018-05, Income Taxes (Topic 740): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118, which updates the income tax accounting in U.S. GAAP to reflect the SEC interpretive guidance released on December 22, 2017, when the Tax Act was signed into law. Additional information regarding the adoption of this standard is contained in Note M.

In August 2018, the FASB issued ASU 2018-15, Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract, which aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. The standard is effective for interim and annual reporting periods beginning after December 15, 2019 and can be applied either prospectively to implementation costs incurred after the date of adoption or retrospectively to all arrangements, with early adoption permitted.

We early adopted ASU 2018-15 as of October 1, 2018, under the prospective method. Additional disclosure regarding capitalized implementation costs is included within Note I.

Accounting Pronouncements Not Yet Adopted

In February 2016, the FASB issued ASU 2016-02, Leases, which will supersede existing lease guidance and will require all leases with a term greater than 12 months to be recognized in the statements of financial position and eliminate current real estate-specific lease guidance, while maintaining substantially similar classification criteria for distinguishing between finance leases and operating leases. This standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018, with early adoption permitted.

We adopted the new standard on January 1, 2019 and used the effective date as our date of initial application. Consequently, financial information will not be updated and the disclosures required under the new standard will not be provided for dates and periods before January 1, 2019.

The new standard provides several optional practical expedients in transition. For the fiscal period beginning January 1, 2019, we have made the following elections. We elected the "package of practical expedients," which permits us not to reassess under the new standard our prior conclusions about lease identification, lease classification and initial direct costs. We did not elect the use-of hindsight or the practical expedient pertaining to land easements; the latter not being applicable to us. The new standard also provided practical expedients for an entity's ongoing accounting. We elected the short-term lease recognition exemption for all leases that qualify which means we have not recognized right-of-use ("ROU") assets or lease liabilities for these leases, and this included not recognizing ROU assets or lease liabilities for existing short-term leases of those assets in transition. We also elected the practical expedient to not separate lease and non-lease components for all leases.

This standard has a material effect on our financial statements beginning January 1, 2019. The most significant effects relate to the recognition of approximately $15.0 million in ROU assets and $15.0 million additional lease liabilities on our balance sheet for our existing operating leases.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments. The amendment in this update replaces the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses on instruments within its scope, including trade receivables. This update is intended to provide financial statement users with more decision-useful information about the expected credit losses. This ASU is effective for annual periods and interim periods for those annual periods beginning after December 15, 2019. Entities may early adopt beginning after December 15, 2018. We are currently evaluating the impact of the adoption of ASU 2016-13 on our consolidated financial statements.

In February 2018, the FASB issued ASU 2018-02, Income Statement – Reporting Comprehensive Income (Topic 220), which allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Act and requires certain disclosures regarding stranded tax effects in accumulated other comprehensive income. This guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018, with early adoption permitted during interim or annual periods. We believe the adoption of this standard will not have a material impact on our consolidated financial statements.

NOTE B – Business Acquisitions

EDIAdmin

On October 3, 2018, we completed our asset acquisition of EDIAdmin, a privately held company providing end-to-end integration solutions, featuring a dedicated Integration Platform as a Service ("iPaaS") called Cloud Hybrid Integration Platform ("CHIP") and collaborative managed services for leading systems and applications, both cloud and on-premise. Pursuant to the asset purchase agreement, we paid $7.5 million in cash to the owner of EDIAdmin. The purchase agreement also allowed the seller to receive up to $1.7 million in cash, which becomes payable in first quarter 2020 and 2021 contingent upon the completion of certain revenue milestones at December 31, 2019 and December 31, 2020. During the year ended December 31, 2018, we recognized other expense of $0.1 million in our consolidated statements of comprehensive income due to the remeasurement of the contingent liability. See Note E for further disclosures on the remeasurement of the contingent liability. The purchase accounting for the EDIAdmin acquisition is complete as of December 31, 2018.

Purchase Price Allocation

We accounted for the acquisition as a business combination. We allocated the purchase price to the tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values as of the acquisition date. We engaged a third-party valuation firm to assist us in the determination of the value of the purchased intangible assets and of the earn-out liability. The excess of the purchase price over the fair value of net tangible and identifiable intangible assets acquired was recorded as goodwill. Goodwill is attributed to a trained workforce and other buyer-specific value resulting from expected synergies, including long-term cost savings, which are not included in the fair values of identifiable assets.

The purchase price consisted of the following (in thousands):

Cash	$7,461
Fair value of earn-out liability	1,274
	$8,735

The final purchase price is subject to a net working capital adjustment to be determined by the sellers and us, pursuant to the terms of the purchase agreement.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the acquisition date (in thousands):

Current assets	$631
Goodwill	4,871
Intangible assets	3,400
Current liabilities	(57)
Deferred revenue	(110)
	$8,735

Purchased Intangible Assets

The following table summarizes the estimated fair value of the purchased intangible assets and their estimated useful lives:

Purchased Intangible Assets	Estimated Fair Value (in thousands)	Estimated Life (in years)
Subscriber relationships	$ 600	10
Developed technology	2,800	10
Total	$ 3,400	

The purchased intangible assets are being amortized on a straight-line basis over their estimated useful lives. Amortization expense for the period from October 3, 2018 through December 31, 2018 was $0.1 million.

CovalentWorks

On December 18, 2018, we completed our asset acquisition of CovalentWorks, a privately held company providing cloud-based EDI solutions to small- and medium-sized businesses. Pursuant to the asset purchase agreement, we paid $19.4 million in cash and issued $3.4 million in common stock, or 40,478 shares, to the owners of CovalentWorks. The purchase accounting for the CovalentWorks acquisition has not been finalized as of December 31, 2018. Provisional amounts are primarily related to intangible assets. We expect to finalize the allocation of purchase price within the one-year measurement-period following the acquisition.

Purchase Price Allocation

We accounted for the acquisition as a business combination. We allocated the purchase price to the tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values as of the acquisition date. We engaged a third-party valuation firm to assist us in the determination of the value of the purchased intangible assets. The excess of the purchase price over the fair value of net tangible and identifiable intangible assets acquired was recorded as goodwill. Goodwill is attributed to buyer-specific value resulting from expected synergies, including long-term cost savings, which are not included in the fair values of identifiable assets.

The purchase price consisted of the following (in thousands):

Cash	$19,431
SPS Commerce, Inc. common stock	3,371
	$22,802

The final purchase price is subject to a net working capital adjustment to be determined by the sellers and us, pursuant to the terms of the purchase agreement.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the acquisition date (in thousands):

Current assets	$244
Property and equipment	44
Goodwill	15,402
Intangible assets	7,210
Current liabilities	(56)
Deferred revenue	(42)
	$22,802

Purchased Intangible Assets

The following table summarizes the estimated fair value of the purchased intangible assets and their estimated useful lives:

Purchased Intangible Assets	Estimated Fair Value (in thousands)	Estimated Life (in years)
Subscriber relationships	$ 7,100	7
Developed technology	100	3
Trade names	10	1
Total	$ 7,210	

The purchased intangible assets are being amortized on a straight-line basis over their estimated useful lives. Amortization expense for the period from December 18, 2018 through December 31, 2018 was not material.

NOTE C – Revenue

We derive our revenues primarily from the following revenue streams (in thousands):

	Year Ended December 31,		
	2018	2017	2016
Recurring revenues:			
Fulfillment	$190,783	$164,682	$139,645
Analytics	34,447	34,260	32,938
Other	5,424	4,978	4,474
Recurring Revenues	230,654	203,920	177,057
One-time revenues	17,586	16,165	16,096
	$248,240	$220,085	$193,153

Revenues are recognized when our services are made available to our customers, in an amount that reflects the consideration we are contractually and legally entitled to in exchange for those services.